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THESIS

Industrial Pension Systems

by

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INTRODUCTION

INTRODUCTION

Today there is unprecedented interest in industrial pension systems resulting from the general awakening to social problems of every kind that have developed with America's industrialization. The depression period following 1929 emphasized these problems. The present war with its accompanying profits; competition for workers; high taxes, but with liberal provisions for sound pension systems, has provided the incentive for the establishment of pension plans.

When seeking information in a field that has experienced rapid recent growth there is found a dearth of substantial up to date material. With industrial pensions there is no lack of material in booklet form taking up a phase of the subject that the issuer is interested in. Insurance company publications emphasize the advantages of annuity plans, banks emphasize pension trusts, and tax publications stress taxes to the exclusion of all else. Substantial texts were all published before the new growth of interest in pensions and most of them have a partisan point of view. To cite two of them, "Industrial Pensions in the United States" was published by the National Industrial Conference Board in 1925 and, naturally, has an industrialist's point of view.(1) Arthur David Cloud's

(1) National Industrial Conference Board, "Industrial Pensions in the United States", New York, 1925.

book, "Pensions in Modern Industry", emphasizes that old pension plans were instruments of the employers and not, what it is hoped modern plans are, genuine attempts to solve a social problem.(1)

I will try to make my approach to the subject that of a person wishing a reasonably complete understanding of industrial pension systems as a whole, attempting to define them so as to avoid confusion with pension systems established by governments, schools, and other organizations that are not industrial. Enough history to have a better understanding of systems of today will be included with some discussion of the advantages of industrial pension systems and the need for them. A consideration of provisions applicable to all plans will be followed by a study of the different types of plans. The two big government aids to industrial pensions, Social Security and Income Tax, will conclude this consideration of industrial pension systems. By this method of approach I will cover those points in which I am interested and those which, in my opinion, should be understood before attempting to consider any plan for a particular group of employees.

Most of the recent growth in pension systems has been among the thousands of medium and smaller sized companies indicating that there must be many, many people interested in learning more about industrial pensions and their relation

(1) Cloud, Arthur David, "Pensions in Modern Industry", Hawkins and Loomis Company, Chicago, 1930.

to employment and government.[1]

(1) Latimer, Murray Webb, and Tufel, Karl, "Trends in Industrial Pensions," Industrial Relations Counselors, Inc., New York, 1940, p.9.

SECTION I

DEFINITION AND HISTORY OF INDUSTRIAL PENSION SYSTEMS

I. DEFINITION AND HISTORY OF INDUSTRIAL PENSION SYSTEMS

A. What an Industrial Pension Is

1. Retirement Because of Age

The first purpose of a pension system is to provide an income to persons retired from employment because of their having reached an age when they no longer can perform their usual work efficiently. Plans often do provide for payment upon retirement for other causes, such as permanent disability or death, but these payments for other causes usually are only incidental to the main purpose, payment of benefits upon retirement because of age.

Age, or old age, is not a definite time so, while formal retirement plans set an expected retirement age, it is necessary to consider that some people age more quickly than others. This is sometimes provided for by earlier retirement with smaller benefits, but it is still retirement because of age.

2. Periodic Payments

During a worker's life he has been receiving wages or salary paid to him at definite intervals, usually weekly, bi-weekly, or monthly. It was upon these payments that the worker depended for his and his families support. It is to replace these periodic payments of wages or salary, after retirement due to age, that industrial pension systems exist.

It is most convenient, then, for the person retired if the pension payments are made at the same intervals at which he received his compensation for working.

3. Source of Funds

Webster's Dictionary defines a pension as "stated stipend or allowance made by a government or business organization---".(1) To be an industrial pension the source of the payment must be a business organization. The payment may come directly from the business organization, or indirectly through a trust or insurance company under contracts paid for by the employer business organization.

Again, Webster's Dictionary defines a pension as,

> "The portion of an employee's retirement income provided by the employer's contributions under a contributory plan." (2)

This is a most essential distinction and one not well recognized, that to be a pension the retirement income must be paid for by the employer. When an employee pays for a retirement income, or contributes with his employer towards one, the employee's payments are actually purchasing a retirement annuity. The annuity concept is recognized when taxing benefits received by a retired worker, by the Federal Income Tax Laws.(3)

(1) Webster's New International Dictionary, Second Edition, Unabridged.
(2) Ibid.
(3) Regulations 111, Section 29.22(b) (2)-5, See also pp. 109-110.

4. Earned or a Gift

No complete discussion of whether a pension is something earned or whether it is a gift will be made at this point. The doubt arises especially under an informal pension system, administered by the employer, when payments are made not from a fund but from current earnings. The reason for bringing up the question here is to emphasize the change that has occurred in the concept of industrial pensions. From being charity, a gift to a man who could not work any longer, a pension gradually came to be considered as something earned by the employee but arbitrarily withheld by the employer until in the employee's old age it might or might not be paid to him. Today the pension has become recognized as something earned by the employee to such an extent that it occasionally enters into collective bargaining agreements and some rights are quite generally vested in the employee.

From the above we may take a definition of an industrial pension to be--an income to an employee retired because of age, paid to him at regular periods from funds provided directly or indirectly by his employer, a business organization, in consideration for past services.

B. History of Industrial Pension Systems

1. Evolution from Informal Plans

Industrial pensions started very informally and at an indefinite time. They were a natural out-growth of the relationship of employer and employee. This relationship of employer and employee did not become very wide spread until the time of the Industrial Revolution, about 1850 in the United States. In the days when most work was done by hand the aged worker would continue to work at what pace he could and not interfere very much with anyone else. After the introduction of machinery it often proved definitely disadvantageous to keep an older worker employed as he tied up at least one machine, and perhaps a whole series of operations dependent upon the product of the one machine.

With a plentiful supply of younger workers the employer could not afford to keep the older worker on his payroll. If the worker had money enough to live on there was not too much complaint, but if the worker became dependent upon public charity public opinion went against the employer. In order to maintain good-will the employer would pay the employee according to his need as a form of private charity. This system was satisfactory as long as the employing unit was not so large that the management had lost the personal knowledge of the employees' conditions so necessary to satisfactory operation of the very informal system.

As employing units became larger and more employees reached retirement age the very informal plans, or no plans, became burdensome financially. The next step was to set aside profits, while an employee was young and still working, to pay his pension from. At first there was a mere segregation of surplus on the employer's books but as this procedure did not supply funds from which to pay pensions the pension trust gradually came into existence.[(1)]

2. Early Plans

The earliest industrial plans to which I find reference are the plans of the American Express Company started in the year 1875 and that of the Baltimore & Ohio Railroad started in 1880.[(2)]

Table 1.

Number of Industrial Pension Plans Adopted (by Periods)1875-1938

Periods	Number of Plans		
	Contributory	Non-Contributory	Total
1875-1900	1	7	8
1901-1905	2	19	21
1906-1910	3	24	27
1911-1915	10	89	99
1916-1920	17	104	121
1921-1925	16	55	71
1926-June 30,1929	38	20	58
July 1,1929-April 30,1932	60	3	63
May 1,1932-Sept.30,1935	137	2	139
Oct.1,1935-June 30,1937	53	2	55
July 1,1937-Dec.31,1938	83	4	87
Totals	420	329	749

Adapted from: Latimer, Murray, and Tufel, Karl, "Trends in Industrial Pensions", Industrial Relations Counselors, Inc., New York, 1940, p.46.

(1) See p.68.
(2) Latimer, Murray Webb, "Industrial Pension Systems in the United States and Canada", Industrial Relations Counselors, Inc., N.Y., 1932, pp.21-22.

It will be noted that by far the greater number of pension plans established through 1925 were non-contributory plans, that is, true pension plans paid for in fact, if not in essence, by the employer. Many of these old pension plans, however, ran into sufficient trouble so that the whole idea of industrial pensions was long questioned by labor. Labor has opposed industrial pensions oh the theories that they withheld wages from the employee that would otherwise be paid to him in cash, and they tended to tie a man to a job when he might obtain better conditions of employment somewhere else. Another type of trouble these old non-contributory plans ran into was the desire of employees to withdraw the employer's contributions. As early as 1897, when there were only seven or less plans, a case came up in the New York courts of an employee seeking to withdraw the amount credited to him under a non-contributory pension plan.(1)

It was characteristic of these early plans that they were something paid for by the employer, title vested in the employer and unless the employee fulfilled all conditions of good conduct and length of service he was entitled to nothing. Such complete employer control led to accusations that plans were weapons used to coerce employees and also that employees were sometimes arbitrarily discharged just before reaching retirement age.

(1) 53 N.Y. Supp. 98 and 167 N.Y. 530; 60 N.E. 1115, as quoted in Cloud, Arthur David, op. cit., pp.113-115.

3. <u>Growth to 1900</u>

The earliest industrial pension plans in the United States were made by railroads or companies closely connected with railroads. The early plans tended to be non-contributory as was the first plan, American Express Company, but the very next plan, Baltimore and Ohio Railroad, May 1, 1880, was a contributory plan. It was probably due to the poor response to this contributory plan that no others were established until after 1900 and even the Baltimore and Ohio Railroad changed its plan to non-contributory in 1884.[1]

In the manufacturing industries pension plans were slower in developing than they were among railroads and public utilities. There are two known plans established before 1900, Alfred Dolge in 1882, and Solvay Process Company in in 1892.[2] Both of these plans were non-contributory but went out of existence before 1900 because employees sought to withdraw the amounts placed to their credit. Evidently factory workers were not then ready for industrial pensions.

4. <u>Growth to 1932</u>

Up to 1900 the growth of industrial pensions had been very slow chiefly because the pressure of the aged was not felt as much as it was to be later. Until 1900 industrial workers were in the minority as will be found in later discussion.[3] Also the flow of immigration had kept the average

(1) Latimer, Murray Webb, op. cit., pp.22-23.
(2) Ibid., p.39.
(3) See p.25.

age level down. The number of pension systems started after 1900 increased rapidly and continuously until after World War I. During the earlier years of this period the larger companies established their plans, starting with the first enduring plan for a manufacturing company, the plan of the Carnegie Steel Company in 1901. The years 1911 to 1915 saw the greatest actual growth in number of employees covered for, while more plans were established in the period 1916 to 1920 these plans were mostly by smaller companies and the rate, as far as number of employees, was sharply down.(1)

First quite noticeable in the period 1921 to 1925, although gradually becoming evident during the ten years before 1921, was the trend toward employee as well as employer contributions to the pension plans. The chief reason that earlier plans did not have employee contributions was that employers wished to maintain control over the plans and avoid getting pensions too much into employment contracts. As employers found that a pension system had to have as its chief purpose the payment of pensions, and not control over the workers, the new plans were set up as contributory and some of the older ones were modified.

5. <u>Growth 1932 Through Social Security</u>

The growth of private pension plans since 1932 has been quite remarkable. The serious depression following

(1) Latimer, Murray Webb, op. cit., p.43.

1929, as well as the unemployment prior to and since that depression, emphasized the problems of the aged industrial worker. There has been since 1933 an entirely new attitude of government, and to a lesser extent of employers, towards labor. The period has sometimes been called the period of encouragement of labor. From the table on page 15 it will be seen that two hundred and eighty one plans were established from April 30, 1932 to December 31, 1938, an average of about forty two a year. However, the greatest number of these plans saw their beginning during that period before the passage of the Social Security Act in 1935. There was great consciousness of the need for some protection.

When the Social Security Act was passed there was a definite slowing down in the rate of establishment of new plans caused, not only by uncertainty as to the effects of the Act but also, by the fact that now employers and employees were paying out taxes for the purpose of supplying old age security. The interest in industrial pensions was not dead in this period, however, for many of the established plans were undergoing changes to make them fit in with, and supplement, the costs and benefits under the Social Security Act.

With the recovery of business in 1937 and the Supreme Court's ruling on May 24, 1937 that titles II, VIII, and IX of the Social Security Act were constitutional, private enterprise again went ahead with industrial pensions. There was now the added incentive of having a pension under

the Federal act that could be quite easily added to and supplemented by a modest plan contributed to by both employer and employee.

6. 1942 to Present

In 1939 there were only about four hundred and fifteen pension plans in operation in the United States.(1) This is quite small considering the numbers that were established, but improper planning and business failures took a heavy toll. From 1932 through 1938, despite depression and the government system, private pension plans held their own and while, perhaps, no more employees were covered in 1938 than in 1932 there had been a healthy trend towards smaller companies adopting systems of old age pensions.(2) This trend of smaller companies was only an indication of what would, and did, happen when national defense and World War II brought larger profits to many companies and a Federal Excess Profits Tax that made it almost inconsequential whether profits were paid out for employee pension systems or kept until paid to the government as taxes.

The 1942 Revenue Act, usually credited with the recent rush to establish pensions, set provisions for having private pension plans reviewed by the Bureau of Internal Revenue, upon their submission to the Bureau, to determine

(1) Business Week, "Industry Plans Pensions", No. 764, April 22, 1944.
(2) Latimer, Murray Webb, and Tufel, Karl, op. cit., p.9.

whether or not they are acceptable so as to make any pension trust non-taxable, employer's contributions deductible, and employer's contributions non-taxable to the employee until such time as the employee receives his pension. The following quotation will indicate the tremendous number of plans in operation and being contemplated.

> "Pension Trust Approvals: As of Nov. 15, the record shows: plans submitted--5804; favorable rulings--3731; adverse rulings--10; plans completed and awaiting amendment--1669; plans not yet worked upon--394." (1)

These figures show that there have already been submitted almost fourteen times the four hundred and fifteen plans that were in existence in 1939. Even the plans that have been favorably ruled upon are nearly nine times the number of plans in existence in 1939.

7. Number of Plans and Coverage

Apparently there are no very recent statistics as to the total number of plans in existence but it should be safe to assume that most pension trust plans have been submitted to the Internal Revenue so would be included in the figures given in the paragraph immediately preceding. While it is not necessary to submit the plan to the Bureau of Internal Revenue for approval it is very adviseable to do so as the results can be very disadvantageous if it is later found that a plan will not qualify.(2)

(1) Accountant's Weekly News Letter, Vol. 3, No. 10, December 4, 1944.
(2) See p.111.

As to the number of employees covered by industrial pensions, there are, again, no very accurate figures. In 1930 it was estimated that there probably were five million employees covered. As was stated earlier in this chapter there was no increase in coverage of employees from 1932 to 1938.(1) This same statement may well hold true also for the period 1930 to 1932 for, while there was a considerable number of new plans established in this period, it was also a period of business failures. If it is, therefore, estimated that there were still about five million employees covered in 1938, it must be considered that there are more than that number as of today because of all the new plans established, even allowing that most of them are in companies without very large working forces.

(1) See p. 20.

SECTION II

NEED FOR AND ADVANTAGES OF INDUSTRIAL PENSION SYSTEMS

II. NEED FOR AND ADVANTAGES OF INDUSTRIAL PENSION SYSTEMS

Industrial pension systems are an attempt to alleviate the problems our present industrial system has forced upon the aged worker. That there is great need for these pensions will not often be denied, but the indirect advantages are not so well recognized.

A. Development of Industrial System

Commons and Andrews have very well summarized the results of the development of industry upon the aged worker.

> "The rapid development of industry, among its other results has placed emphasis on the individual's physical vigor and wage-earning capacity. It has deprived old age of the esteem bestowed upon it under more primitive patriarchal conditions, and after a life of productive toil it relegates to the background the aged or incapacitated man as a useless, uneconomic factor. Failing health, inability to find employment, lack of means, often absence of friends willing or able to help him--such is the prospect which confronts, in the great majority of cases the aged worker." (1)

This is the situation which all pension plans seek to relieve. Social Security has tried to help but, as we shall find later, has proved insufficient. (2) There are annuities available

(1) Commons, John R. and Andrews, John B., "Principles of Labor Legislation", Harper & Brothers, New York, 1936, p.273.
(2) See p.84.

to an individual, but usually a man's income is barely sufficient to maintain his home and family at the level he wishes, leaving nothing for savings or the purchase of annuities.

Modern, high-speed, methods of work are entirely different from what they were even one hundred years ago. Until about 1850 there was little real industrialization in the United States. Men had greater opportunities for economic independence, for business was carried on by small units giving any worker an opportunity to become his own master. If opportunities in trade or manufacturing were not sufficiently good there was still free land in the West to which a man might move and enjoy, as Commons and Andrews have just said, the greater security of the "more primitive patriarchal conditions". In the United States just before the Civil War factory methods and large scale industry started to grow. The Civil War gave the new movement great encouragement and more and more people became industrial workers. By 1900, according to the Census, the number of industrial workers for the first time exceeded the number of farmers and farm workers.[1] By 1940 the number of industrial workers exceeded the number of farmers and farm workers by more than two to one.[2]

(1) 11,852,956 to 10,381,765, Twelfth Census of the United States, 1900.
(2) 19,785,229 to 9,003,702, Sixteenth Census of the United States, 1940.

The factory, because of its high speed, causes "old age" at a comparatively young age for,

> "Industrial injuries or sickness or overstrain may make workers prematurely old. Furthermore, many machine jobs may require such speed and deft motions and such great adaptability that older employees cannot turn out the required amount of product without severe strain and liability to accidents." (1)

At the same time that industry scraps humans at a younger age medical science has progressed and while it has not increased the life span it has increased the life expectancy. To elucidate, take sixty five years to be the average span of life. A greater number of people reaches that age than forty years ago, but no appreciable greater number survives it. (2)

If neither the worker nor his government is going to provide sufficient income for his old age, who but the employer can. The employer has received the benefits of the worker's best and useful years, should he not be responsible for the declining years?

B. Employers' Point of View

It is not sheer altruism that motivates an employer when he provides some form of retirement plan for his employees.

(1) Daugherty, Carroll R., "Labor Problems in American Industry", Houghton Mifflin Company, New York, 1941, p.122.
(2) "Funk & Wagnalls New Standard Encyclopedia", Unicorn Press, New York, 1944, Vol. XXIV, p.398.

It is good business, under the proper circumstances, to provide pensions for super-annuated employees, in fact, it is often times a very profitable investment.

1. Stabilization of Employment-Cut in Turnover

Labor turnover is a very costly factor in running a business. It has been estimated that the average cost of replacing factory workers is four and a-half percent of payroll.[1] Another estimate would set an average of $300.00 per worker replaced.[2] In addition to the cost of an employment department such other items as cost of teaching new employees, spoiled work, slowed down production, damaged tools and machinery and greater liability to accidents, must be considered. A large labor turnover is usually indicative of a poor personnel policy or lack of policy.

2. Increased Morale and Loyalty

Decreased labor turnover is not the only benefit to an employer from a pension plan. Employees do appreciate their employer taking sufficient interest in them to think of their future financial problems, if the employees are convinced of the employer's sincerity. A plan should be established with the idea of paying retirement benefits to those employees who meet the requirements for benefits. No real benefit will be realized by the employer unless he has this as his primary

(1) Cloud, Arthur David, op. cit., p.439.
(2) Hackett, J.D., "Labor Management", D. Appleton and Company, New York, 1929, Chapter 20.

intention and takes the resulting benefits as a by-product. Early experience with industrial pensions failed to show an increase in employee loyalty and goodwill chiefly because the employer was not sincere.

It is quite understandable that the employer wishes to protect himself against future contingencies by making his contributions subject to cancellation and even providing for the total discontinuance of the plan. Any plan containing such provisions is, however, unsound and employee goodwill is often more harmed by such a plan than it is increased. To be truly effective a plan must be sound, sincere and unequivocal. Modern plans usually recognize this, and if the payments are going to be deducted for income tax purposes, the soundness and unequivocalness must be unquestionable. If an employee is going to have large credits available to him if he is separated from his employer isn't he going to have an incentive to quit? Methods of dealing with this will be discussed later.[1] It is worth neting here that anything that increases employee goodwill decrease labor turnover, for a worker is not likely to quit if he thinks it is "great" to be working here.

3. Orderly, Humane Elimination of the Superannuated

Having stated that employee goodwill should not be sought as a direct benefit of a pension plan, but rather taken as a by-product, we come now to a much more direct benefit,

(1) See p.53.

humanely getting rid of the older workers. The older men or women have, in peace times, very little place in our modern industrial system. They become more prone to accidents, are more often out sick and are slower than a worker in his prime yet are often in the top wage brackets. As long as there are sufficient younger workers, an employer in a competitive field must use the younger men yet to discharge the older workers without provision for their support is going to very adversely effect employee morale. Workers will start to worry about their old age and feel bitter over the treatment of their old fellow-workers. An embittered and worried working force is not an efficient working force.

If no formal pension plan has been adopted, yet the employer does not wish to discharge the older worker with no income, what alternatives are there? First, the worker can be left right on the job and the employer take the consequences of lower production. Second, leave the worker on the job but cut his pay. This might seem a good solution, since an older worker usually has less need of money than a man with a growing family, but an employee is seldom satisfied by it and often union agreements would forbid such action. A third possibility is to give the aged worker lighter or different work. However if an employee's job is anything that requires a good deal of skill, or something of which he can be proud, he will never willingly accept anything requiring less skill. Then there remains the solution of retiring the employee and paying him something while he is not working. This is the start of

informal pension plans. An advantage to the employer, not to be overlooked, is that removing older men allows an influx of younger men with young and new ideas.

4. Attraction of Better Class Employees

The ability of a company to attract the better grade of employees depends to a large degree upon the public and employee goodwill that the company has built up. The better type employee approaches a company, where he is seeking a job, with the idea of long-term employment and a man thinking in terms of long-term employment is going to consider the reputation of the company and the advantages it offers. The company that attracts employees is also going to have a large group from which to select its employees.

5. Public Relations and Goodwill

No company can afford to ignore the public and the public's opinion. Among the group vaguely called "the public" are the families of the employees. It is most important to "sell" the company to these families. Pension plans, health and life insurance, and other plans from which the employee's family does, or may, derive benefits are great goodwill builders. There are always occasions when some annoyance will arise on the job. On such occasions it makes very much difference whether the worker's family's attitude towards the employer is favorable and friendly or critical and hostile.

To a company that has direct contacts with the public, such as a manufacturer and distributor of consumer

goods, the goodwill built up by good employee relations is vital. A company considerate of its employees is going to be considerate of the public and its customers. Satisfied workers turn out better products.

6. Tax Savings

Tax angles of pension plans will be considered in detail in later chapters.(1) At this point let us just consider what an advantage it is to the employer if he can so qualify his pension plan under the income tax laws that his contributions are deductable yet not taxable to the employee at that time. It is Section 23 (p) of the Internal Revenue Code which permits the employer to make deductions of contributioms to a qualified employee trust or annuity plan in computing net income. Today if an employer is subject to the Excess Profits Tax, 95%, nearly all of his contribution to the pension plan would be saved from his tax bill. It is not proper to consider only this case, however, as after the war we may not have an Excess Profits Tax. At the present rates of normal tax and surtax a saving of forty percent of contributions to pension plans may be expected.(2)

The unusual part is that a deduction allowed the employer is not taxable to the employee until years later when distributed. This is accomplished by Section 165, as amemded by Section 162, of the Internal Revenue Code.

(1) See chapter VII and VIII.
(2) Internal Revenue Code, Sections 13 (b) and 15 (b).

C. Employees' Point of View

As there can be but little doubt that a pension system has many advantages for an employer, so too a pension system gives many advantages to the employees covered. How valuable these advantages may be is pointed out in a recent National Association of Cost Accountants Bulletin.

> "Recently, a concern offered a brilliant junior executive of a major distilling company an excellent opportunity to change his position and come with it. His reply was that, because of the employee benefit plan in effect at the distilling company, he would have to get an increase in pay with the other organization of at least fifty percent in order to break even with the benefits being obtained with his then employer." (1)

Monetary benefits, however attractive, are not the only employee benefits obtained as may be seen in the sections that immediately follow.

1. Relief from Worry

There are but few employees not covered by a retirement plan who can look forward to old age and not worry about their financial circumstances or, who having reached old age, know they need have no money fears no matter how long they may live. There are, also, but few people who will argue that benefits under title two of the Social Security Act are adequate. We know that the average worker is unable to save, of

(1) Simons, Gustave, "Latest Developments in Employee Benefit Plans", N.A.C.A. Bulletin, Vol. XXVI, No. 9, January 1, 1945.

his own initiative, sufficient during his working life to help him in his old age. The more a man gets in his pay-check the higher his plane of livimg is going to be. Being better paid he is not going to live as he did when he had smaller wages, and save the difference, but is going to spend most of what he gets. Then he is going to keep worrying about his future. A pension provided by a private plan added to benefits under the Social Security Act will give the worker much nearer the money he has been used to than Social Security benefits alone.

2. Encouragement of Thrift

An industrial pension plan will encourage thrift in several ways. A worker who knows he will receive a definite pension when he reaches the age of retirement will be encouraged to save sufficient on his own initiative to supplement the pension. Perhaps his pension will cover the necessities and his savings will enable him to do those things he has always wanted to do but did not have time for.

It is to the employer's benefit that a worker who has learned to be thrifty of his own resources is also going to be careful of his employer's property. In addition to this reason for being thrifty, an employee who is going to receive a pension is planning on being with the employer for a long time so the employer's continued existence and financial well being is of great concern to the employee. He is going to save for his employer.

3. Indirect Pay Increase

Planned correctly, under most pension plans, the employee receives what amounts to an indirect increase in his pay in the amount of his employer's contribution to the pension plan. A formal pension plan provides for the present setting aside of money in order to be able to pay pensions in the future. If the employer did not set up a pension plan he could increase the employee's wages by the amount he would contribute to the pension plan and, at first glance be in the same financial position. Then, theoretically, the employee could take the pay increase and with it purchase an annuity to provide an income when he reached the retirement age. Convinced that pension payments are an indirect pay increase, consider how much better the pension plan is than a direct pay increase would be.

It is not at all certain that the employee would use the extra money to purchase retirement benefits, but if he did he would find that he had only about three-quarters of the money provided by the employer, for Federal Income Taxes would have taken at least twenty three percent.(1) Had the money been paid by the employer direct to a trust or to an insurance company under a qualifying plan it would not have been subject to tax until paid out as a pension when it would be taxable in the lower income brackets.(2)

(1) Normal tax and surtax, Internal Revenue Code, Sections 11 and 12.
(2) Internal Revenue Code, Section 165 (a).

Then, again, the employee could not buy the same benefits for the price as the "load", or addition to the rate to cover the cost of doing business, on an individual annuity policy is greater than on a group.

4. <u>Indirect Benefits</u>

Very often a pension plan will have some provisions that protect an employee's family should he die before reaching the pension age. The extent and nature of these death benefits depends upon the scope and type of the plan and the types of insurance and annuity contracts used under the plan where it is underwritten by an insurance company.

A type of unemployment and disability insurance is the result of providing, in some plans, for an employee's own contribution, and perhaps some of the employer's contribution, to be available to him should he leave the employ of the company. If the employee is old enough, although not having reached the regular retirement age, he may under many plans start receiving retirement benefits but at a reduced rate.

It has also been claimed that employees benefit from lower labor turnover when they are covered by a pension plan. This is based on the theory that all labor costs are borne by the employees and if the cost of labor turnover is reduced there is that much more left for higher wages of the employees.[1]

(1) Cloud, Arthur David, op. cit., Chapter XXIII.

D. The Point of View of the Public

During recent years there has been a growing public concern over the care of the aged. In the past a worker was supposed to provide during his working life for his old age. If he was unable to do so there was public and private charity to provide the necessities of physical existence. Today there is old age assistance, supported by State and Federal Governments to care for those not otherwise provided for.

The trend in the public's point of view is, however, away from charity and toward providing for the aged through pensions which the worker has himself earned or paid for; not only should the worker not be compelled to accept charity, but the public should not have to support a person who has spent his working life in private employment.

Social Security's basic idea is in keeping with the view that industry and the worker should provide for the worker's retirement. An objection to retirement benefits under the Social Security Act is that they are not actuarilly sound. Greater benefits in proportion to contributions are given to lower income workers than to higher income workers thus either overcharging the higher income group or combining charity with insurance for the lower income group and calling it all insurance.

Another aspect of the problem with which the public is very much concerned is the unemployment of workers

who are getting old yet are not so old as to be useless, even in industry. Employers are reluctant to hire these people not only because younger workers may cost less and produce more but because the employer does not want the older worker on his payrolls a few years hence when he will be too old to work. A solution to this is for the worker to stay with one employer who has a benefit system to cover him. It is admitted, however, that this unduly ties a worker down and may not be in the best interests of labor. Some system similar to the Railroad Retirement might overcome the objection of tying labor to one employer.(1)

(1) See p.92.

SECTION III

PROVISIONS OF INDUSTRIAL PENSION PLANS

III PROVISIONS OF INDUSTRIAL PENSION PLANS

It will, of course, be recognized that all of the possible provisions to go into an industrial pension plan cannot be covered, nor can more than an indication of the usual provisions be given. Provisions will vary according to the type of plan selected, the needs which an employer recognizes and wishes to cover, restrictions and rulings of trustees, governments , and insurance companies. Very recently unions have taken an interest in private pension plans of the employers, so collective bargaining will have a part in determining provisions.(1)

A. Employees to Come Under the Plan

Plans may make membership voluntary or compulsory, available to all employees of the employer, or only those employees of a given class. Classes of employees to be covered or excluded may be determined by such factors as age, sex, length of service, nature of employment or amount of compensation.

1. Nature of Employment

An employer may wish to cover only certain classes of his employees such as salesmen and office employees, or

(1) Business Week, op. cit., p.70.

he may wish to cover all of his employees except for hourly paid workers. When reading about industrial pension systems it would seem that such selections were the usual thing. However, in 1929 eighty percent of the pension plans then in operation made no distinction, all types of employees were eligible to join the plans.(1)

Section 165 of the Internal Revenue Code sets forth certain restrictions on the exclusion of employees from membership in a plan, but does not forbid exclusions providing plans do not discriminate in favor of executives, officers, shareholders, or supervisors. Unless there are types of jobs that are filled by seasonal or migratory workers, it would seem that an employer should not exclude any class of workers just because they are that class.

2. <u>Amount of Compensation</u>

The amount of compensation has recently become a very real problem in determining what employees will be included or excluded from a plan. Under early contributory plans low paid employees were sometimes excluded because they would not be able to contribute. Employees with high salaries have often been limited as to the amount of salary that would be considered in determining payments to a pension plan. Salary in excess of a certain sum may be entirely excluded or it may be taken at a lower rate of

(1) Latimer, Murray Webb, op. cit., p.61.

contributions.

Treasury Department Regulations 111, Section 29. 165-4, states that a plan must not discriminate in the amount of contributions nor amount of benefits for officers, stockholders, or other supervisory employees. However, it is specifically stated that a plan will not be considered discriminatory merely because,

> "The contributions or benefits bear a uniform relationship to total compensation, or to the basic or regular rate of compensation, or merely because the contributions or benefits based on the first $3,000. of annual compensation of employees subject to the Federal Insurance Contributions Act differ from the contributions or benefits based on the excess of such annual compensation over $3,000." (1)

There have been some very recent rulings on methods of intergrating private pension plans with Social Security so that the private plans will meet the Treasury Department's tests as to non-discrimination. These methods will be taken up in the section on Social Security.(2)

3. <u>Length of Service and Age</u>

Not all plans are too much concerned with the two groups of requirements already discussed, nature of employment and compensation, but almost all plans do have eligibility requirements connected with length of service and the age of the employee. The length of service requirement may vary from a few months to as many as five years, the purpose of

(1) Regulation 111, Section 29.165-4.
(2) See Pages 89-92.

the requirement being the elimination of the extra cost and trouble caused by having temporary employees and drifters constantly joining and leaving the plan.

In addition to a minimum service requirement for regular employees to be able to join the plan, there should be taken into consideration the eligibility of employees who work fewer than the usual number of hours each week or who, while they work for the employer regularly year after year, do not work more than a few months each year. Such provisions were at one time subject only to agreement between the parties to the plan but today, as in so many other things, there are some government regulations. To qualify the plan with the Treasury Department, employees who work not more than five months out of any twelve may be excluded, as may any employee who works not more than twenty hours in one week.(1)

Requirements as to age when joining a pension plan generally have two purposes. A minimum age, sometimes set, has the same purpose as a minimum length of service requirement. It is quite well recognized that young employees move from jobs much more than older ones for the reasons that they can more easily obtain jobs, they may not have determined what their life work will be, and they are more free and adventuresome. The other requirement as to age is usually that an employee be less than a certain maximum age to be eligible to join the pension plan. The reasons for the maximum age

(1) Regulations 111, Section 29.165-3.

limit, if one exists, is to prevent the plan from being too costly if a definite amount of retirement income is purchased each year for each employee, or to keep out of the plan such employees as have little chance of building up reasonable retirement benefits before they are forced to retire. A typical maximum age is fifty five years, allowing for ten years of service before the usual retirement age of sixty five.(1) Typical minimum ages often run from twenty eight years to thirty five years of age, allowing from twenty five years to thirty five or more years in which to build up benefits.(2)

4. <u>Compulsory or Optional Membership</u>

There does not appear to be any law or regulation covering compulsory membership in an industrial pension plan. Under a non-contributory plan the question would not arise. Under a contributory plan it will be necessary to decide if membership is to be optional or compulsory.

Compulsory membership as a condition of employment for all new employees may be desirable and works no hardship. Compulsory membership for present employees may work a little immediate hardship but has ample justification.

The justification for compulsory membership is that eventually the employee may need the retirement benefits. The employer wants to feel that provision is made for all

(1) See p.50 for provisions for workers already over maximum age.
(2) Gardner, Esmond B., and Weber, C. Jerome, "Pension, Bonus, and Profit-Sharing Plans", The Chase National Bank, New York, 1943, p.31.

his employees and that when they become too old to work he may humanely retire them. In addition to the employer's feelings there is his asset goodwill to be considered. If some employee does not join the plan and then when he is old becomes a public charge, there is a reflection to the detriment of the employer.

B. Eligibility for Pensions

The requirements for joining a pension system, which have just been discussed, and the requirements for obtaining a pension, after having joined such a plan, are quite different. The former are much the easier to determine and interpret, while under the latter many difficult and border line cases are certain to arise no matter how carefully eligibility requirements are drawn up. For this reason an employer often insists upon having a trustee to administer the plan even though the services of a trustee would not otherwise be required by the nature of the plan. To have an impartial administrator to deal with the employees' claims will insure the better carrying out of the objective of the plan uninfluenced by likes and dislikes and the relations between employees and their supervisors. Such questions as the continuity of employment, length of service, or how to handle a disabled employee's benefits, may have to be decided by the trustee.

1. Years of Service

The length of service of an employee is of prime importance in determining his eligibility for a pension. Not only does the length of service indicate, in some measure, the employee's contribution to the success of the business and his loyalty to the employer, but upon length of service is often dependent the amount that has been contributed to the pension fund in anticipation of the employee's retirement.

In those plans paid for entirely by the employer there are almost always minimum service periods specified as conditions for retirement with a pension. Many of these plans, in addition, require that the period of service be continuous, but continuity may be interpreted in various ways. Seldom is it insisted upon literally for in a period of twenty or more years there are many reasons why there may be a break in service. Temporary absence because of illness is usually disregarded and the time lost counted towards the period of service, but on a protracted leave of absence the time is usually disallowed in figuring length of service but is not counted as a break in continuity of service. A lay-off for lack of work is usually not counted toward length of service but is not considered a break in continuity of service.(1)

As to the actual number of years of service required there are some wide variances, from five to forty five years being the extremes. Ninety five percent of the plans having

(1) National Industrial Conference Board, Inc., op. cit., pp.74-75.

a period of service requirement are said, at one time, to have had fifteen to thirty years as the stated period.[1] The most common period is twenty years and the next most common, twenty five years.[2]

2. <u>Fixed Age</u>

It is the common practice to set an age at which employees are supposed to retire. Often there is one age fixed as a suggested retirement age and another fixed as a compulsory retirement age. One of the reasons a retirement plan appeals to an employer is that it is a way to humanely clear his business of "dead wood". The compulsory retirement age is very much to his advantage in such cases but, on the other hand, there may be other old employees who are still alert and because of experience are very valuable to the employer. To cover this situation it may be found advisable to include provisions that with the employer's and employee's consent active employment can continue beyond retirement age, perhaps paying both salary and retirement benefits.

Upon the inauguration of a plan difficulty will be encountered with a fixed retirement age if there are employees approaching retirement age. The simplest solution is, perhaps, to waive, in the case of these employees, the compulsory retirement age and provide that they may retire after being covered by the plan for, say, ten years. Under a plan that is set up so as to recognize the past service of employees

(1) Ibid, p.77.
(2) Cloud, Arthur David, op. cit., p.137.

there may be little or no need to make an exception, these employees can be retired at the fixed retirement age. Sixty five is now the most common retirement age while many plans establish an earlier age for women.(1)

3. Disability

There is always the question while the plan provides for retirement upon reaching old age, what will happen if the employee cannot work until he reaches old age? Some provision for early retirement is usually made in a pension plan, the details varying according to the type of plan and the provisions written into the plan. Under group annuity contracts early retirements are usually limited to a period of ten years prior to normal retirement date. If the plan is based upon contracts with an insurance company there may be written into the contracts provisions for the waiver of premiums and the payment of disability benefits, but these provisions are not really pension plan benefits.

Under a trust plan, such as one that contemplates the accumulation of funds with which to purchase present annuities upon the retirement of employees, there are at least two possibilities. The first would be to purchase, if possible, what annuity payments the accumulated credits of the employee would allow from an insurance company. The other possibility would be to make the accumulated employer and employee contributions available to the disabled employee

(1) Simons, Gustave, op. cit., p.458.

either in a lump sum or in periodic payments of an amount determined to be best after considering the employee's needs and the total available.

C. Amount of Pension

It is not proposed to here consider actual dollars and cents amounts of pensions to be paid to employees but rather to consider some of the factors that enter into a determination of the amount of pension benefits. Some plans must state far in advance of retirement an actual dollar amount of benefits that will be available, but due to the fluctuating value of the dollar in terms of what it will buy a plan that adjusts itself somewhat to such fluctuations will be more satisfactory.

1. Future Service

Age and sex determine to a considerable extent what retirement benefits will be payable, but even more important in determining the amount of benefits is the total amount of contribution. There are two ways of determining the amount of contribution, either an employer, and his employees, decide what they can afford, or wish, to pay as contributions to the plan and let the amount of retirement benefits be what these contributions will purchase; or a desirable amount of retirement benefits may be determined and then contributions in amounts sufficient to purchase these benefits be made.

To use the definite benefit approach yet give consideration to the employee's length of service, the sum of a percentage of each year's compensation as the annual retirement benefits might be used. That is, if one and one half percent is used and the employee works thirty five years before retirement his retirement income would be fifty two and one half percent of his average annual compensation. If the amount of retirement income is not weighted by the number of years worked, a definite percentage of average or final salary may be used, such as forty or fifty percent, and a minimum service requirement established, say ten, fifteen, or twenty years. This latter method benefits particularly those employees who enter employment at a higher than average age. (1)

The money purchase formula usually requires the employer, and perhaps the employee, to contribute a certain percent of payroll to the retirement fund and let these amounts purchase what benefits they may. This limits the expense to the employer but what benefits are purchased will not be certain because in addition to changes in compensation, survival, and other factors will be the fluctuations in the earnings of the fund.

2. Past Service

The problem of past service only comes up when a plan is newly established. If only future service is to be taken into account the plan might well not exist as far as an employee already near retirement age is concerned. To

(1) Business Week, op. cit.

pay out at one time an amount sufficient to cover all the past service on the same formula that future service is to be figured on would, in most cases, involve prohibitive expense. Solutions to this problem vary considerably. The very old workers may be pensioned off upon reaching retirement age, but the retirement income may come out of the employer's current operations instead of coming from the plan set up to care for other retirements. If the plan calls for retirement income of a percent of earnings times years of future service, there may be added years of past service to this formula but figured at a lesser percentage than the future service. This will increase the pension for the older worker to some extent but not increase the employer's cost as much as figuring past service on the same basis as future. Provision is usually made to spread the cost of past service either over the remaining working life of the employee or over a fixed period of years.

3. Changes in Compensation

Pension benefits which are based upon a money purchase formula will automatically take care of either increases or decreases in the amount of compensation, as the contribution is usually a specified percentage of pay. When benefits are on a definite benefit basis, changes in benefits do not come automatically with changes in compensation. The most common procedure is to set up classes, or ranges, of compensation and increase or decrease contributions only when an

employee moves from one class to another.[1] It is also fairly common to provide that increases or decreases in compensation during the last ten years before retirement are to be disregarded in figuring amounts of pension benefits. This seems quite fair to both employer and employee for increases in amount of pension for one close to retirement age are very expensive and, on the other hand, if compensation falls off due to an employee's decreased production he is not penalized in his pension for it. This theory is almost the exact opposite of provisions found in plans twenty five or more years ago where retirement benefits were based upon the average compensation for the last ten years at a certain percentage times the number of years of service. The great increase in wages during the last war increased the benefits of those who retired soon after to such an extent that many plans rah into financial difficulties.[2]

4. Maximums and Minimums

Maximum pensions are determined usually by providing that compensation in excess of certain amounts either will be disregarded entirely or will be taken into consideration only at a lesser rate than ordinary. On recent plans there is seldom a minimum pension specified because no matter how small a pension it will add to the benefits receivable under Old Age Benefits.

(1) See p. 61.
(2) Conant, Luther Jr., "A Critical Analysis of Industrial Pension Systems", The MacMillan Company, New York, 1922, p.212.

D. Rights

1. Employer's Rights

Both employer and employee have certain rights under a modern pension plan. The employer usually reserves the right to discontinue or suspend his contributions to the plan for the reason of eliminating the possibility of employees forcing his making contributions to the fund indefinitely. The employer will also reserve the right to modify or terminate the plan but not to "diminish any rights of members in prior contributions".(1) The Internal Revenue Code requires that it be impossible, prior to the satisfaction of all claims of employees and their beneficiaries, for any part of the corpus or income of any fund to revert to the benefit of the employer.(2)

2. Employees' Rights

To carry out the purpose of the plan and to protect members it is customary to include a provision that no member has any legal or equitable right not specifically granted in the plan. In addition there should be a provision that membership in the plan does not give any right to be retained in the employ of the company, nor may a member assign, hypothecate or subject to any lien his benefits and rights under the plan.

In the event of severance of employment the employee is entitled to any contributions he has made to the plan and

(1) Gardiner, Esmond B., and Weber, C. Jerome, op. cit., p.47.
(2) Section 165.

in addition any of the employer's contributions in which he may have a vested right. The provisions of the plan may give the employee different severance rights depending upon the cause of the separation, giving greater rights in the case of involuntary separations. Frequently it is provided, in order to curb voluntary separations just to obtain a large sum of cash, that severance payments will not be paid in cash but may only be received in the form of retirement payments.

SECTION IV

TYPES OF PLANS

IV TYPES OF PLANS

There are three basic types of pension plans: group annuity, trustee, and individual policy. Pension benefits under a profit sharing system may be classed as a separate type, as may also informal plans, but as the latter often breaks down into no plan at all and the former may not have retirement benefits as its primary benefits they are not usually classified as basic types.

It is not possible to select any one type and say that it is the best because there are too many factors to consider in selecting a plan. Each company must decide what it wants to do and which type will best accomplish what it wants to do. It has been well said that there are almost as many types of plans as there are plans, since each individual situation differs in many material respects. (1)

A. Informal Plans

Informal pension plans are not generally classified as one of the basic types of plans but as they are historically the first, and from their inadequacy grew the other types, let us consider these informal plans first.

(1) Insurance Research and Review Service, "Pension and Other Employees Trusts", Indianapolis, 1943, p.13.

1. Transfers, Demotions, and Cut in Pay

The most simple and perhaps the most natural method of treating an employee who has grown old in the employ of an organization is to find a type of work that he can do despite the handicap of age. This usually involves either transferring the worker to a different department, a different type of work, or giving him the easier, less skilled, work to do.

Another closely related practice is that of leaving the aged employee on his old job but taking into consideration his smaller production and paying him accordingly. These various practices will often work but union opposition, the affect upon other employees of having a fellow worker who does not keep the pace, and reluctance of an employee to take less pay or a poorer position may make them undesirable.

2. Retirement With Some Pay

Either because the practices listed in the section above prove undesirable, or because an employee may not be able to perform any type of service, the employer may pay him his usual pay, or more often some lesser amount, and receive no service for the pay. The amount of the payments are determined by the employer and usually bear a relation to the needs of the employee. It has been said by employers that the more "American", independent, way to take care of old age was for the employer to not promise old age benefits but let the employee be thrifty and provide for his age.

Should the employee incur misfortunes that prevented his providing for his own old age then the employer at his discretion should provide small payments to the worker.(1) Such a system is too much like charity and also discriminates against the careful, thrifty, employee.

3. Discretionary Pension Plans

As the number of employees to be pensioned became greater and the top management did not know of the circumstances of each old employee, there were set up plans that approached, in some ways, the modern formal plans. The chief reason that they cannot be classified with formal plans is that they were too much subject to the employer's control, too discretionary.

Definite plans were made, reserves created on the books, and the employees notified as to the plans and the conditions for eligibility for retirement benefits. Employees were given definite reasons to expect pensions. Usually a board was selected to administer the plan and determine employees' eligibility, but the board was representative of management and most often was given such broad discretionary powers as to make the receipt of a pension far from a certainty. These plans contain a statement that they are voluntary, constitute no contract, and vest no rights in the employees.

This earlier type of plan is, as far as I can

(1) National Industrial Conference Board, Inc., op. cit., p.43.

determine, non-existent at the present time. It became too much in disfavor as employees became organized and too disadvantageous financially, administratively, and under the tax laws.

B. Group Annuities

Group annuities is a type of retirement system that is quite widely used by larger groups which desire retirement benefits and not a great many other benefits subsidiary to the retirement benefits. A plan will not ordinarily be written for a group smaller than fifty and a group of two hundred to two hundred and fifty sometimes is set as the minimum sized group.(1)

1. Contractual Insurance Plan

A plan based upon group annuities is a contractual plan, as distinguished from a trust plan.(2) A single master contract is negotiated between the employer and the issuer, an insurance company. The employer pays stated premiums to the insurance company and the insurance company agrees to pay the pension and severance benefits due under the contract. Each employee participating in the plan receives a certificate telling him his benefits under the plan.

(1) Insurance Research and Review Service, op. cit., p.16.
(2) For definition of trust plan see "Pension Trusts",p.68.

This type of plan does not necessarily involve employee contributions but very often they are included. Each year an amount of single premium deferred annuity is purchased for each member of the group, usually on an annual basis, and the sum of these yearly purchases determines the amount of benefits available to the individual employee upon retirement. The cost of the plan and size of yearly annuity purchased depends upon age, sex, and methods of determining the contributions to the plan. If a fixed amount of contribution is to be made by the employer, say a percentage of the employee's pay, then as the employee gets older the amount of annuity purchased each year will become smaller. If, however, the employer's plan of contribution is such as to each year purchase a fixed amount of annuity for each employee then his costs are going to increase as the employee gets older. If the company is young or for other reasons has not now many old employees, it will find this latter plan cheaper now but as the years go on it may become prohibitively expensive.(1)

2. <u>Benefits</u>

Group annuities are primarily to pay retirement benefits, but the employer can contract with the issuing insurance company to include many other types of benefits.

(1) Gardner, Esmond B., and Weber, C. Jerome, op. cit., p.52.

It should always be kept in mind that the more types of benefits included in a contract the greater the cost, or smaller the retirement benefits. One provision always included in group annuities when there are employee contributions is that upon death before retirement, or upon separation from the employer, at least the amount of the employee's contribution will be refunded, sometimes with a low rate of interest added. Sometimes a provision is made for an employee leaving the employer to receive credit for the employer's contribution to the group annuities. This would come about when the right to the part purchased by the employer had been "vested" in the employee. Usually to receive these employer paid for benefits the employee must leave his contributions with the insurance company and receive only the right to annuity payments upon reaching retirement age. This provision has the good result of not encouraging an employee to leave his employment merely because he might in that way obtain a large amount of cash.(1)

3. Optional Settlements

It is sometimes the privilege of the annuitant to select an optional settlement of the amounts due him under the annuities. He may wish to have the payments made to him during his life and to some beneficiary after his death for the remainder of the beneficiary's life. The payments to the beneficiary may be in the same amount as to the

(1) Cloud, Arthur David, op. cit., p.102. See also p.53.

original annuitant or they may be in a smaller amount. In any case the insurance company will figure the actuarially equivalent annuity which will, of course, make the benefit payments smaller, but the surviving spouse or other dependent will be protected.

4. Changes in Compensation

If the retirement plan contemplates providing a fixed amount of retirement benefits for each employee then changes in compensation during the employee's working life would not make any great change in the amount of contributions to the purchase of the annuities. The more usual plan, however, does not aim at a definite amount of benefits at retirement except in a general way. Usually the employer's and employee's contributions bear some relation to the earnings of the employee and the amount of the annuity purchased is determined by these payments, age, and sex of the employee. Too frequent changes in the amount of contribution are undesirable both from the point of view of the insurance company and the payroll department of the employer. It is quite customary to keep contributions in even dollars by providing that adjustments in the amount of contributions to the annuity will not be changed until the employee's pay goes into a different range. If contributions of five percent are required and payments made monthly then a range of two hundred and forty dollars in yearly compensation might be set which would

require contributions of one dollar a month.[1]

5. Past Service

Past service presents quite a problem in setting up any retirement system. The older employees have served long and faithfully but, if annuities are provided for them based solely upon future service, they have a very poor chance of accumulating an adequate retirement income. For an employer to attempt to make up for past services in full would involve a very great outlay of cash, especially when it is considered that the older an employee is the more expensive is the purchase of each dollar of retirement income.

Two things are commonly done about past service. First, the past service is taken into consideration but is provided for at a lesser percentage than is future service. Second, the total amount of money necessary to pay for past services of all employees is determined and arrangements made to pay this amount over a period of years. To be certain that the oldest employees' annuities are paid for in full by the time they reach retirement age the money is usually first applied to purchase annuities for the oldest workers and then gradually work backward and buy those for the younger ones having past service credits.[2]

6. Non-Payment of Premiums

If premiums under a group annuities plan are

(1) Gardner, Esmond B., and Weber, C. Jerome, op. cit., p.53.
(2) Wyatt, Birchard E., "Private Group Retirement Plans", Graphic Arts Press, Inc., Washington, 1936, pp. 47-50.

stopped, or if the plan is discontinued, the employees have all the benefits provided by the annuities already purchased. They may let these annuities stay and when the employees reach retirement age receive just the benefits from these, or they may wish to withdraw their contributions to the annuities already purchased. Under the circumstance of the plan being discontinued this is usually permissible, but the employer's contributions may not be withdrawn but only received by the employee in the form of retirement benefits.

As do most all insurance policies, group annuities plans provide a period of grace after the due date of the premiums during which they may be paid. It is usual, also, to have provisions for the reinstatement of contracts within a period of from one to two years if they have lapsed due to the non-payment of premiums.

C. Individual Annuities

Individual annuities purchased separately for each employee, just as he might purchase them privately, is another type of insurance contract that may be used in an industrial pension system. This type of contract does not lend itself as readily to a system as a group annuities contract but may be used with a trust, and occasionally alone. If used alone the contracts must be issued in the names of the employees and the employees must have full

ownership of the contracts in order to segregate them from the other assets of the employer for tax purposes.

1. Types of Contracts

Individual annuities may be purchased in many forms. They may be purchased on a single premium basis or on an annual premium basis, as immediate annuities or as deferred annuities. The contracts may contain provisions for refunds upon death, before and after the installment annuity payments begin, and provisions for actuarially equivalent options. Many insurance companies will not issue annuity contracts without a life insurance element unless the employee cannot physically qualify for life insurance.

With these contracts, as with insurance generally, the fewer the benefits the lower the cost. The cheapest, if permitted by the state, is a deferred annuity with no refund and no cash surrender provisions. On the other extreme would be a contract providing cash surrender value, refund of premiums on death before retirement, or the payment of an insurance value, and the payment of a designated number of annuity installments certain. When the contracts are payable to a trust it is advantageous to have some of these extra provisions written into the contracts as in the event of death of one of the annuitants the trust fund would benefit by the obligation of the insurance company to pay the extra benefits.

2. Death, Disability, and Severance Benefits

Death benefits under individual annuities may be very substantial. As was noted in the section immediately preceding almost all have a life insurance element.(1) The reserve value at maturity of a contract for retirement at age sixty five with one hundred and twenty monthly annuity installments certain is approximately fifteen hundred dollars for each ten dollars of monthly annuity. Using this as a start let us figure what death benefits may be available. The term life insurance element written into this type of contract is for approximately one thousand dollars for each ten dollars of monthly annuity. Each premium payment therefore goes towards paying for this term insurance until the cash surrender value equals or exceeds the term insurance. When this occurs the term insurance is dropped and the death benefit available is the cash surrender value. Therefore the death benefit is at all times somewhere between one thousand and fifteen hundred dollars for each ten dollars of monthly annuity.

Disability benefits may be financed, especially if the contract is under a trust, either by earlier retirement benefits being taken under the retirement contract at a smaller amount or the actual cash value being paid out in installments to the disabled worker.

Upon severance of employment, depending upon the

(1) See p. 64.

employer's policy and the reason for discharge, there are several possibilities with individual annuity contracts. The contract may be assigned to the employee without cost or it may be assigned to the employee upon payment of all, or part, of its cash value. In this way, if the employee wishes, he may keep up the payments himself and receive the benefits of the lower original rates because of his younger age when the contract was originally taken out. Another possibility is to merely refund the employee's contributions and use any excess cash surrender value towards paying future premiums on other contracts. Still another possibility is to convert the original contract into a paid up contract for a lesser amount and assign this new contract to the employee.[1]

(1) Gardner, Esmond B., and Weber, C. Jerome, op. cit., pp.60-61.

SECTION V

TYPES OF PLANS (CONTINUED)

V. TYPES OF PLANS (CONTINUED)

Having taken up informal and annuity types of plans in the preceding section, this section will take up pension trusts and deferred profit sharing plans. Since 1942 pension trusts have acquired much public notice due to the Revenue Act of that year. Deferred profit sharing plans are appropriately named, neither "pension" nor "annuity" is suggested by the title, and deferred profit sharing plans do not provide old age pensions as their chief objective.

A. Pension Trusts

Pension trusts, unlike individual or group annuities plans, are not definite methods of investing contributions for pensions, nor yet definite means of obtaining the retirement benefits when they come due. A pension trust is merely a living trust, the purpose of its creation being the holding, management, and investment of funds turned over to it and the payment of benefits in the form of pensions or such other benefits as may be provided for. Its chief advantage is in its being a separate legal entity, apart from the employer, employees, insurance companies or others with whom it may have dealings.

1. Planning and Administrative Problems

If a pension trust is set up and the trustees

instructed to purchase only individual or group annuities the problems of the trust will be much simplified, most of the planning and calculations being done by the insurance company and the trust and trustees left chiefly as impartial administrators and holder of the legal title.

A trust that does not anticipate such limited investments, however, presents some real planning problems. Assuming a rate of return on the trust investments and considering age, sex, length of service, compensation, and perhaps experience tables for mortality, severance, and disability, the amount or amounts to be paid into the trust must be determined which will provide funds for paying benefits when due. At intervals these calculations must be rechecked to provide for variances from the assumptions originally made and to provide for inclusion of new beneficiaries.

The powers and duties of the trustees must be considered and defined and the rights of the employees under varying circumstances also made clear. The actual selection of investments may be left to the trustees but often the trust instrument will specify the general nature these investments are to take.

2. Flexibility

Trust plans are considerably more flexible than insurance company plans can be and for this reason may, under some circumstances, be more desirable. Practices that are possible under a trust plan using insurance, but would not be

possible under a plan wholly administered by an insurance company, are well summarized in the following quotation:

> "The employer may wish to postpone the vesting of rights in the...employee, he may wish to inject conditions of forfeiture in case of premature severance or acts of disloyalty, he may want to reserve any right to borrow on, or pledge, the policies for the benefit of the plan." (1)

In the matter of investments a trust fund may be extremely flexible if proper provisions are made in the trust instrument. In the larger trusts it may be found desirable to invest funds in United States Government Bonds, securities legal for a life insurance company, securities legal for trusts, common and preferred stocks, or insurance policies of various kinds. Insurance policies may be life or annuity policies on key men in the company payable to the trust and often purchased with the thought that upon the death or retirement of these key men the earning capacity of the company may be so seriously affected that contributions might be curtailed or discontinued. Sometimes trusts are authorized to, and do, invest their funds in notes, bonds, or stocks of the employer corporation. Such a practice is not usually to be recommended and it raises the question of whether the trust were created exclusively for the purpose of providing employee benefits. The Treasury Department may question if the trust did not also have the purpose of providing a market for the

(1) The Research Institute of America, Inc., "Pension and Profit Sharing Trusts", New York, 1944, p.4.

employer's securities and at, perhaps, too high a price.(1)

Flexibility is also attained under a pension trust by allowing the trustees,within limits, discretionary power to provide for contingencies and to make decisions involving benefits, eligibility, status of employees during leaves of absence, and other situations. Pension trusts may also make for more varied retirement and disability benefits. A greater selection of actuarially equivalent annuities may be available than would be under optional settlement provisions of insurance contracts.

3. Separate Entity

Pension trusts are separate legal "persons" and as such can hold legal title to insurance and other assets while the equitable title is with the employees. The trust receives its funds from the employer and, perhaps, employees, invests the funds and accumulates the income. In the matters of investment of funds and accumulation of income it is similar to any other trust with the exception that no strict segregation of corpus and income need be made as there is but one class of beneficiaries under the trust. Investment of the funds may be decided, according to provisions of the trust, by the trustees, the pension committee, or any combination of the trustees and pension committee. A pension committee is a group appointed by the employer, or the employer and employees,

(1) Regulations 111, Section 29.165-1.

to decide questions arising under the pension plan and to advise the trustees. A pension committee is not necessary as such functions may be left for the trustees.

4. Contributions and Benefits

Today most plans including trust plans are contributory, requiring contributions from both employer and employee.(1) The amounts contributed will vary according to the benefits sought and be based upon the other factors taken up in the first part of this section.(2) Should the trust funds be invested only in insurance company annuities the amounts of contributions will be determined by the insurance company. In the older type of trust, when the services of an insurance company are not used to accumulate funds, the amounts of contributions will vary with the success of the trustees in obtaining high interest rates, making profits on sales of securities, and avoiding losses. As with any other type of plan, the more additional benefits given the higher the contribution rates will be. Severance rights, disability benefits and death benefits may be some of these additional benefits.

Trust plans that accumulate funds by ordinary investment methods may pay benefits out of current income or accumulation as the benefits become due. A quite common variance from this is to take, at the time an employee is ready

(1) 75% were contributory in 1938 and almost all new plans since that year have been contributory. See Latimer, Murray Webb, and Tufel, Karl, op. cit., p.7.
(2) See p.69.

to retire, a lump sum from the trust fund and purchase an immediate annuity that will provide the employee with his proper periodic payments, or take that portion of the trust fund that has been accumulated for that employee and purchase what benefits that amount will buy. Usually the type of fund that does not depend upon insurance must not provide too great benefits when employees leave. Either all employer's contributions will be forfeited or they should be made available only as retirement benefits. Employee's contributions may be refunded, with or without interest, but an incentive to prevent the employee from taking his contributions in cash should be provided.

5. <u>Discontinuance</u>

Should it be necessary to temporarily discontinue making contributions to a pension trust any shortage may usually be made up at a later date. Upon permanent discontinuance of contributions to the trust the employees do not lose anything already paid into the trust, for to qualify the trust under Treasury Department Regulations,

> "It must be impossible for the employer (or other nonemployee) to recover any amounts other than such amounts as remain in the trust because of 'erroneous actuarial computations' after the satisfaction of all fixed and contingent obligations." (1)

The assets of the trust can be equitably divided among the

(1) Regulations 111, Section 29.165-2.

beneficiaries according to the "actuarial present value of the plan benefits then accrued for each".(1) Actual distribution of assets may then be made or distribution may be deferred and the amounts used to provide pension or other benefits to whatever extent possible when they become due. Discontinuance of a plan as soon as older executives were provided for was forseen as such an easy way to discriminate that much attention has been paid to that phase by the taxing authorities.(2)

B. Deferred Profit Sharing

Under deferred profit sharing plans it may be only incidental if any benefits are available to an employee when he leaves his employment because of age. Deferred profit sharing plans are set up as a form of employee trust but the emphasis is not on pensions but on the employer's contributions to the plan, which are in varying amounts.

1. How a Pension Plan Fits In

Deferred profit sharing plans are an outgrowth from regular immediate profit sharing plans which had proved to be rather unsatisfactory to both many employers and employees. Profit sharing plans were established as an incentive to employees to consider the business and work harder and save for

(1) Weber, C. Jerome, and Gardner, Esmond B., op. cit., p.66.
(2) See p.114

the employer who would, in return for this, share his profits with the employees. The amount to go to the employees would be determined by a fixed formula and might be a percentage of all profits, a percentage of profits in excess of some fixed amount, or a percentage of dividends paid to stockholders.

Few enduring benefits are realized by the employer or the employee from an immediate profit sharing. The amounts received are quickly spent and as soon as distributions have been made for a few consecutive years they are considered by the employees to be part of their wages, and the employees and their families raise their living standards accordingly. If profits are not sufficient in some year to make a distribution employees feel wronged and the employer loses all the good his previous profit sharing has done. To overcome the objections to the immediate distribution of profit sharing benefits, systems of deferred profit sharing were set up under which profits were shared as usual but paid into a trust under which they were to be accumulated until the lapse of a fixed number of years, the attainment of a stated age, illness, disability, death, or the severance of employment. If none of the other conditions for payment use up the employee's funds first, or if it is planned that shared profits will be used only for retirement benefits, then the deferred profit sharing plan

becomes an industrial pension system.

2. Administration

The deferred profit sharing system is set up as a trust and the trust assets are in care of a trustee or trustees. The trustees may administer the plan alone or there may be a board of directors or an advisory committee set up to administer the plan and advise the trustees. Any such board or committee usually includes officers or directors and representatives of the employees.

3. Contributions

The employee does not in most cases contribute in money to a profit sharing system, but when there are retirement benefits, especially if they are being purchased under some insurance contract, there is no very great objection to employee contribution except the additional administrative work involved and a possible change in employee severance rights.

The employer's contributions to the plan are not in a fixed amount and are not made to provide for any fixed amount of future benefit. While a company may stop its contributions to a pension fund it may hesitate because of the financial and psychological results of such a cessation upon its employees. In a profit sharing plan there is no implied or contractual obligation to make contributions to the fund unless profits in a designated amount are realized. The system is extremely fluid and adapts itself to the employer's

financial condition.[1] Contributions are based upon profits or dividends and are credited to the individual employees usually on the ratio that their earnings bear to the total payroll, or in the ratio that their base pay bears to the sum of all base pays.

4. Distributions

Distributions under a deferred profit sharing plan may be much more numerous than under any other type of system that has been considered. While our chief concern is in retirement benefits it will be necessary to mention also the other types of distributions encountered. Any immediate distributions must be considered in relation to the present Wage and Salary Stabilization controls. All distributions should be deferred until an employee has had a minimum period of membership in the plan.

Profit sharing plans may provide that upon the death of a member any balance of his benefits under the plan will be distributed to his beneficiaries or heirs. Upon severance of employment benefits from employer contributions are usually granted in full, but distribution may be deferred for a number of years or distribution may be made in installments. Any life insurance or annuity contracts carried on the employee may be assigned to him and he can either continue to pay for them, take paid up insurance, or secure the cash surrender value. Distributions may also be made to participants in

(1) Simons, Gustave, op. cit., pp.461-462.

case of illness, disability or other events that cause decrease in, or cessation of, earnings.

The method of distributing benefits after the lapse of a certain period or the attainment of a certain age may be left to the advisory committee or it may be outlined in general in advance. A certain indefiniteness of necessity goes with the benefits since they are not actuarilly determined. The total to the credit of the retiring employee will be determined when he stops work and this amount could be paid to him in a lump sum or, if annuities had been purchased, the trustee could assign the contracts to the employee or request that payments be made directly to him. Another common method of distribution is to determine the life expectancy of the retiring worker and pay him installments over this expectancy in amounts sufficient to use up the funds to his credit. The disadvantage of this plan is that there is no obligation to continue payments should the employee outlive his life expectancy.

5. Rights and Forfeitures

Participants in a profit sharing plan should be prohibited from assigning their interests in the plan or subjecting their interests to any lien. They may be given the privilege of borrowing from the plan but should not be given any right to do so. Participation in the plan should not give an employee any right to be maintained in the employ of the employer. Plans also usually provide that no

participant shall have any legal or equitable rights in the plan not specifically granted. The employer reserves the right to modify or terminate the plan but not to recover any part of the funds which are for the exclusive benefit of the participants.

The vesting of rights of members in the contributions of the employer may be conditioned upon a certain requirement such as ten years of service. It has sometimes been provided, also, that employee rights will be forfeited in the case of crime or other gross misconduct, or if the participant should die leaving no close relative or dependent. Any employee contributions cannot be forfeited, of course, and any rights in the employer's contributions which are forfeited may not come back to the employer but must be credited to the remaining participants.[1]

(1) Gardner, Esmond B., and Weber, C. Jerome, op. cit., p.92.

SECTION VI

INDUSTRIAL PENSIONS AND SOCIAL SECURITY

VI INDUSTRIAL PENSIONS AND SOCIAL SECURITY

As has already been pointed out, the Social Security Act has had a great effect upon industrial and other forms of pensions.(1) Many people who had not previously given much thought to retirement incomes now had the subject brought to their attention. Existing pension plans had to be, or were, modified to fit in with the new benefits, but perhaps most important was that the benefits under the Social Security Act made a beginning for a retirement income which could be supplemented by a small additional pension that by itself would be entirely inadequate. Before going further into the effects of Social Security upon industrial pensions it would be well to examine the benefits under the old age and survivors insurance section of the Social Security Act.

A. Retirement Benefits Under Social Security

All retirement benefits under Social Security are figured on the "primary insurance benefit" as determined by the following formula: To forty percent of the first fifty dollars of average monthly pay is added ten percent of the balance of the average monthly pay. To this sum is added one percent of the sum for each year in which two hundred

(1) See pp.18-20.

dollars or more was earned. The minimum retirement benefit is ten dollars a month and the maximum eighty five dollars a month. (1) (2)

Average monthly pay is determined by adding all pay received while in covered employment since January 1, 1937 and dividing this total by the number of months elapsed since that date. Wages or salaries in excess of three thousand dollars a year are excluded. From this one point, of excluding wages and salaries in excess of the first three thousand dollars a year, arises a great many provisions in private pension plans. Because of these provisions much income tax legislation has been passed to prevent discrimination in favor of the higher paid officers and employees of a company seeking deduction of the cost of the private retirement plan from taxable income. (3)

An employee must be retired from covered employment, have been covered at least six quarters, and be at least sixty five years of age to be eligible for old age benefits. Should he have a wife also sixty five years of age he will receive half again, but not in excess of eighty five dollars total, his primary, or monthly, insurance benefit.

It would not be proper to leave the subject of

(1) Public Law No. 271, 74th Congress, Title II, Social Security Act.
(2) See p.84for typical benefits.
(3) See p. 103

benefits under Social Security without pointing out that there are also survivors' benefits. A widow,after she becomes sixty five years of age, receives three-fourths of her husband's primary benefits, or if she is caring for her children under eighteen years of age, regardless of her age, she receives three-fourths of the primary benefits and each child one-half. These benefits are limited, however, to the smaller of eighty five dollars, eighty percent of the worker's average monthly pay, or twice the primary benefits.

B. Need for Supplementing Social Security Benefits

There are at least two faults with retirement benefits under the Social Security Act. First, there is a fairly high and absolutely inflexible age when retirement benefits start. Second, the amount of benefits in nearly all cases is too low.

In recent years, excluding the war period, the older worker has found it increasingly difficult to obtain employment should he lose his job, and increasingly difficult to hold his place when employed. Industrial injuries, or sickness, or over strain, may make a worker prematurely old. Usually an industry does not pay a worker sufficient during his working years to enable him to maintain a decent plane of living and still save to support

himself after he has become "too old" to work.(1)

Under the Social Security Act no difference is made in ages of retirement between women and men although it is usual to find in private plans that women are retired about five years younger than men despite the greater life expectancy of women than men. Had it not proved necessary and advantageous to retire women at an earlier age the practise would not be found in so many plans.

Whatever a retired employee's income had been his benefits under the Social Security Act, as it now stands, are far from adequate. Following is a table of primary insurance benefits, the amount a single retired worker would receive under varying conditions.

Table 2.
Primary Insurance Benefits
Under Old Age and Survivors' Insurance,
Title II, of the Social Security Act of 1935.

Average monthly pay	Years of Coverage					
	3 years	5 years	10 years	20 years	30 years	40 years
$50.00	$20.60	$21.00	$22.00	$24.00	$26.00	$28.00
100.00	25.75	26.25	27.50	30.00	32.50	35.00
150.00	30.90	31.50	33.00	36.00	39.00	42.00
250.00	41.20	42.00	44.00	48.00	52.00	56.00

Adapted from: Industrial Relations Institute's "Social Security", New York, 1942, p.9.

From this table it may be noted that a man who for forty years has averaged three thousand dollars a year, two

(1) Daugherty, Carroll R., op. cit., p.122-123.

hundred and fifty dollars a month, is going to receive only fifty six dollars a month or twenty two and four tenths per-cent of the income he has been receiving. If he has a wife also sixty five years of age they will receive eighty four dollars a month, or approximately one-third of his average earnings.

It has been estimated that the monthly income necessary for a single person to maintain a "minimum health-and-decency standard" of living from 1918 to 1935 has ranged from $46.67 to $58.33 and a "minimum-comfort standard" from $74.16 to $91.67.(1) These figures indicate that had Social Security been paying benefits during this period, 1918 to 1935, even the man who had averaged three thousand dollars a year for forty years would not have received benefits, during most of the period, sufficient to maintain "minimum health-and-decency" standard.

From another point of view, M. Albert Linton, president of the Provident Mutual Life Insurance Company, said in an address before the National Conference on Social Security that,

> "One of the fundamental principles of a sound social insurance system is that benefits should be held to a subsistence level so that there may be ample scope to provide additional benefits through individual initiative and enterprise, and that there may be a minimum of temptation to lie back and rely upon government handouts." (2)

(1) Daugherty, Carroll R., op. cit., p.138.
(2) Committee on Social Security, Chamber of Commerce of the U.S.A., "Social Security in America", January, 1940, p.59.

This may be Mr. Linton's and other insurance company officials' idea of a sound system but as individuals the workers of the United States have been financially unable to provide these additional benefits. With the aid of the employers under industrial pension systems a part of the workers have been able to obtain some additional benefits.

C. Industrial Pensions for Incomes over Three Thousand Dollars Only

It had been often the custom to provide pensions for only officers and higher paid employees, especially in the smaller companies, but today, because of tax disadvantages this procedure is not as popular as it was. After passage of the Social Security Act, or the starting of benefits under that act, there was definite cause to provide industrial pensions for only those who had income in excess of the three thousand dollars figured under the Social Security Act. The employer was taxed for this first three thousand dollars of pay to the employee. Had he been planning on paying a percentage of the employees' pay into a retirement fund this new tax added to his own payments made the total percentage greater for the lower paid workers, the ones the Social Security Act most benefited.

The employer attitude of letting the lower paid workers be taken care of under the federal plan while the

employer provided additional benefits for the more highly paid workers and executives worked out fairly well until the high income taxes and excess profits taxes came. Then with definite tightening up on deductions and further safeguards against discrimination under the Revenue Act of 1942 a plan that discriminated in favor of higher paid employees and officers became very disadvantageous to the company.(1)

Still it is the people in the "middle income" group who find it hardest to provide adequately for old age. The high income group may be able to invest their excess income, purchase annuities, or otherwise provide for their old age; the low income group is fairly well provided for by the Social Security Act benefits. The group in between spends all its income to provide a higher plane of living and pay taxes which are fairly high for this group. As a result they have little, if anything, left to purchase supplementary benefits to the far from adequate benefits under the national system. An industrial system of old age pensions is about the only solution to this group's problem.

D. Changes in Existing Pensions to Adapt to Social Security

The industrial pension plans that were in operation prior to the passage of the Social Security Act were established without any idea of a Federal act so there had to be

(1) See pp.101-103

many adjustments to avoid duplication of benefits and costs.

1. Factors Involved

The first thought of an employer might be to discontinue his private pension plan entirely, but employment contracts and good will must be considered. In addition the employees already retired and those who have nearly reached retirement age must be considered. Those employees already retired would be entirely deprived of pension benefits and the older workers would have only nominal benefits under Social Security.

If the private plan is not discontinued it may be so modified as to supplement the federal benefits. The amount of federal benefits may be deducted from the benefits provided under the plan or the benefits may just be reduced, considering the national benefits, but not in the exact amount of those benefits. When employee contributions are involved it is usually unsatisfactory to just deduct the benefits under the Social Security Act from the original amount because it will be particularly unfair to the lower paid worker.

2. Changes Made

The type of change made in an industrial pension plan to make it fit in with Social Security naturally depended to a great extent upon the type of plan in existence before 1935. The non-contributory type of plan lent itself well to what is sometimes termed the "envelope" adjustment. The "envelope" adjustment is the deduction of Social Security

benefits from the benefits under the old private plan and the paying by the plan of only the excess over Social Security benefits. Out of two hundred and sixty one contributory plans studied as of December 31, 1938 for changes to adjust to the Social Security Act it was found that one hundred and fifty three had made some adjustment but of those only three were of the envelope type. In non-contributory plans fifteen out of seventeen that changed were made into envelope type of plans. (1)

The most common adjustment was to have contribution and benefit rates differ on earnings below and above three thousand dollars each year, and this was carried so far in some cases as to entirely drop those employees earning less than the three thousand dollars.

E. Approved Methods of Correlating Plans with Social Security

The Internal Code was very simple in its language and stated that a plan under which contributions or benefits differed for compensation excluded from Social Security from that included in Social Security was not to be considered discriminatory. (2) However this provided too big a loop hole so regulations and a Treasury Decision attempted to close this hole. (3) A Treasury Department Mimeograph was

(1) Latimer, Murray Webb, and Tufel, Karl, op. cit., p.73.
(2) Section 165 (a) (5)
(3) Treasury Decision 5278.

also issued to give detailed instructions as to how benefits were to correlate with Social Security to avoid being ruled discriminatory.(1)

The basic idea is that if a plan provides for one rate for employees earnings below a certain amount, usually three thousand dollars annually, and another for those over three thousand or entirely excludes those under a certain amount the total benefits received under the plan and under Social Security must be proportionate for those over and under the certain amount. The Social Security benefits are figured as one hundred and fifty percent of the primary insurance benefits and it is determined that a man earning three thousand dollars would be entitled to seven hundred and twenty dollars a year as of January 1, 1937, or twenty four percent of the three thousand dollars. Adding one percent for each year would bring this benefit up to 25.21 percent of three thousand dollars by January 1, 1942. Rounded off to twenty five percent and increasing twenty five one hundredths percent annually is therefore taken as the base by which benefits are to be correlated.

That is, if your private plan takes in only employees earning more than three thousand dollars you may pay an employee upon retirement twenty five percent of his average earnings in excess of three thousand dollars increased by twenty five one hundredths percent of such

(1) Treasury Department Mimeograph 5539.

earnings for each year of service after 1941. If the employer prefers he may use another formula which is: seventy five one hundredths percent of average pay in excess of three thousand dollars times the years of past service, plus one percent of average pay in excess of three thousand dollars times the number of years from the start of the plan.

As an example: An employee earned five thousand dollars a year for thirty years after 1941. Twenty five one hundredths percent times thirty is seven and one half percent which added to twenty five percent equals thirty two and a half percent. Thirty two and a half percent of the two thousand dollars, in excess of the first three thousand dollars, is six hundred and fifty dollars a year the maximum pension which may be provided under this intergration formula.

The second formula might work as follows: The same as in the previous example except that the employee worked ten years before the plan became effective and twenty years after. Ten years of past service at three quarters percent a year is seven and a half percent, plus twenty years at one percent, gives a total of twenty seven and a half percent. This percentage of two thousand dollars is five hundred and fifty dollars a year for pension.

If some division is made other than at the three thousand dollars covered by Social Security, there are tables provided in mimeograph 5539 giving the percentages to be substituted for the twenty five percent and twenty

five one hundredths percent mentioned above.

F. Taxability for Social Security of Employer's Contributions

Section 1607 (b) (2) of the Internal Revenue Code as amended by the Social Security Act Amendments of 1939 provides that employers' contributions to an employee, to a fund, or for insurance under a plan for retirement shall not be considered wages for the purpose of the tax imposed upon employers for Social Security. If they are not wages they are not subject to tax. However the same section provides that if the contributions are made to provide for death benefits then the employee must not have any right to receive cash in lieu of the insurance, nor any right to assign the policy, nor receive its cash value even upon termination of employment. This restriction upon death benefits should be considered when planning a system of industrial pensions, especially when setting termination rights, and is one more argument for having a trusteed system to hold legal title to any insurance providing death benefits.

G. Railroad Retirement Act of 1937.

There is an important group of private industrial workers who are not covered by Social Security but are covered by a special federal law, the Railroad Retirement Act of 1937. The interstate railroad, express, and Pullman employees are

covered by this act along with the Carriers' Taxing Act of 1937. This federal plan not only provides for future retirements but also takes over from the railroads the payment of retirement benefits to employees already retired as of March and July, 1937.

The rates and benefits are higher than under Social Security, the tax on employer and employee being two and three quarters percent each and increasing to three and three quarters percent by 1949; the benefits ranging from a minimum of forty dollars to a maximum of one hundred and twenty dollars. Social Security taxes are still one percent for employer and employee and benefits range from a minimum of ten dollars to a maximum of eighty five dollars. The amount of monthly annuity, under Railroad Retirement, is calculated by taking two percent of the first fifty dollars of average monthly earnings, one and one half percent of the next one hundred dollars, and one percent of the remainder up to three hundred dollars, and then multiplying the sum by the number of years of service.

By taking a somewhat smaller annuity an employee may provide for his wife after his death. Provision is made for everyone to retire at age sixty five but such retirement is not compulsory. Workers with thirty years of service may retire at age sixty but receive one third less benefits. Annuities are also provided for completely disabled workers at age sixty or after thirty years of service.

This is a plan administered by the government yet financed by the employers and employees. It is an industrial pension plan with employee contributions made uniform for an entire industry through the intervention of the government.

SECTION VII

INDUSTRIAL PENSIONS UNDER FEDERAL INCOME TAX

VII INDUSTRIAL PENSIONS UNDER FEDERAL INCOME TAX

There have been Federal Income Taxes in the United States continuously since 1913 and during most of that time it has been recognized that there was social good in industrial pension plans which should be encouraged by favorable tax legislation. With the high tax rates that became effective in 1940, pension plans became such popular means of tax avoidance that the Revenue Act of 1942 practically revolutionized the tax status of pension plans while encouraging the establishment of sound plans really benefiting the employees.

A. History

A study of the history of tax laws is always helpful in more easily understanding the present laws and calling attention to the significant points. If in addition to the actual previous provisions of the laws the rulings of the courts and Treasury Department and the discussions that preceded the enactment of the laws are known then a very complete understanding of the significance of the latest laws may be had. It is my purpose here to give only a very brief account of previous laws and then go on to the present.

1. Beginning to 1926

Under the Revenue Act of 1918 the statutes were construed to allow the deduction, as ordinary and necessary

business expenses, of amounts paid to employees as pensions or amounts put into a trust for the benefit of employees.(1) However it was also construed that if these were deductions for the employer they were income for the employees and the individual employees must include any amounts paid for their benefit, even into a trust, as income in the year so paid. This situation caused the first income tax legislation specifically mentioning employee trusts to be included in the Revenue Act of 1921.(2) This section provided that when an employees' trust was created as part of a "stock bonus or profit sharing plan" for the exclusive benefit of some or all of the employees neither the principal nor income of the fund would be taxable to the employees until such time as the funds were distributed or made available for distribution, and then only to the extent that distributions exceeded employee's contributions. An interesting point to observe here is that it made no difference under this Act, nor any other prior to 1938, whether the trust was revocable or irrevocable. Prior to this 1921 Act employer's contributions were taxable to the employee unless there was <u>much</u> doubt that the employee would ever receive anything. Now a trust could be set up, the employer take deduction for his contributions, the employees not be taxed, and then the trust be revoked.

(1) Tarleau, Thomas N., "Development of Legislation on Pension Trusts", Journal of Accountancy, Vol. 77, No. 5, May 1944, p.376.
(2) Section 219 (f).

2. <u>1926 to 1942</u>

After the passage of the 1921 Act, which did not mention pensions specifically, there was considerable doubt as to their status and whether or not they came under Section 219 (f).[(1)] To clear up this doubt the Revenue Act of 1926 amended this section, but the only real change made was to include the word "pension" making the section read, "stock bonus, pension or profit sharing plan".

In the 1928 Revenue Act Section 219 (f) became Section 165 and was amended so as to provide that unrealized appreciation on stock distributed should not be taxable, but this amendment concerns profit sharing trusts, cheifly, as do also the amendments made to this section by the Revenue Acts of 1932 and 1936. By 1937 it was quite apparent that pension and other plans had become great means of tax avoidance and there was some effort at that time to tighten up on the requirements, but about the only result was an amendment in the Revenue Act of 1938 to provide that the trusts must be irrevocable.[(2)]

It was also in this period that special provisions were first made for the deduction of employers' contributions

(1) See p. 97
(2) Internal Revenue Code, Sec. 165: "If under the trust instrument it is impossible, at any time prior to the satisfaction of all liabilities with respect to employees under the trust, for any part of the corpus or income to be used for, or diverted to purposes other than for the exclusive benefit of his employees shall be taxable under Section 161."

in excess of the requirements for the current year. The Revenue Act of 1928 provided that any amounts in excess of the current year's requirements should be spread over a ten year period if the plan or trust was exempt under Section 165.(1)

If, in 1937, it was thought that not enough revenue was being lost to bother about through loose provisions allowing discrimination in favor of officers and share holders, the situation became entirely different when defense and war profits, salary and wage regulations, and competition for employees swelled the amounts and numbers of plans. The Revenue Act of 1942 and subsequent regulations of the Treasury Department certainly did something about it.

B. Present Requirements for Qualifying Plan

The Revenue Act of 1942 set up quite rigid requirements for a pension plan which is to receive all the advantages offered by the Internal Revenue Code, but a very helpful step was taken when provisions were made for submitting plans for approval if the tax payer so desired. For qualifying plans there are three advantages: The deduction by the employer of the amount contributed; non-recognition of income to employees until distribution; exemption of the trust or

(1) Revenue Act of 1928, Section 23 (q)

plan from taxation on its income.[1]

1. <u>Exclusive Benefit of Employees or Their Beneficiaries</u>

Section 162 (a) of the Revenue Act of 1942 amends Section 165 to read as follows:

> "A trust forming part of a stock bonus, pension, or profit-sharing plan of an employer for the exclusive benefit of his employees or their beneficiaries shall not be taxable under this supplement and no other provision of this supplement shall apply with respect to such trust or to its beneficiary-".

Conflict with this provision will be encountered in a corporation when an officer, who would ordinarily be classified as an employee, is also a large shareholder, but this situation is also covered by the provisions against discrimination in contributions or benefits. In the case of a sole proprietorship, of course, the plan cannot cover the proprietor as he is not an employee, and the same holds true for partners in a partnership.

To be for the exclusive benefit of employees a trust or plan cannot also serve a purpose of the employer other than those connected with the providing for his employees. That is, the employer will, of course, benefit by being able to retire old workers, probably enjoy greater employee goodwill, and benefit by other like advantages of having a plan, but he may not use such a plan to, for instance, market otherwise

(1) Montgomery, Robert H., "Federal Taxes on Corporations", The Ronald Press Company, New York, 1945, Vol.1, p.429.

unmarketable securities or unload other assets at too high a price. A plan is for the exclusive benefit of employees if it covers only ex-employees or covers both former employees and present employees.(1)

2. No Reversion to Benefit of Employer

A trust is not exempt unless it is impossible under it for either the corpus or income to be used for any purpose other than for the exclusive benefits of the employees. It must be provided that no part, unless due to an actuarial error, may be returned to the employer by operation or natural termination of the trust, collateral agreement, revocation or amendment, or by any other means. However an employer does not have to give up all right to modify or terminate the rights of certain employees, but any rights so modified or terminated may not benefit the employer but must be applied to the benefit of the remaining members. If the fund is based upon insurance contracts even the possibility of actuarial errors will be eliminated.

3. Required Percentage of Personnel

One of the chief loop holes in the law prior to the enactment of the Revenue Act of 1942 was that a plan did not have to benefit employees generally, the statutes read "some or all" employees. Under the 1942 Act there are two standards, one or the other of which must be met, as to numbers and classes of employees to be included in a valid pension plan.

The first standard is figured on percentages of

(1) Regulations 111, Section 29, 165-1.

employees and works as follows: Part time and seasonal workers, figured as less than twenty hours a week and five months a year respectively, may be entirely excluded. New employees may also be excluded but not any who have been employed five or more years. Of the remaining employees if seventy percent of them are eligible under the plan and at least eighty percent of this seventy percent do come under the plan the plan will qualify. The thirty percent of full time, non-seasonal, long time employees that may be excluded from the plan may be excluded because of age, type of work, method of compensation or other reasons.

The second or alternative standard, used when the above percentages are not adhered to, is that a plan be found by the Commissioner of Internal Revenue to be non-discriminatory in "eligibility conditions, benefits, and contributions.(1) The plan must not discriminate in favor of officers, stockholders, supervisory employees or high salaried executives. A plan will not be considered discriminatory merely because it excludes employees covered by Social Security who earn less than three thousand dollars a year or treats earnings under three thousand dollars a year differently than it treats those in excess of that amount if the plan is intergrated with Social Security.(2)

(1) Regulations 111, Section 29. 165-3.
(2) See p.89

4. Not Discriminatory in Benefits Nor Contributions

No matter how else a plan may qualify if it discriminates in favor of stockholders, officers, supervisory employees, or high salaried executives it will not be acceptable to the Treasury Department. It has been seen with what care percentages for participation were defined for the purpose of not allowing a plan to cover merely a small favored group, the same spirit must be carried through and applied also in considering contributions to a plan by the employer and benefits received by all classes of employees. The provisions with respect to contributions or benefits may vary so long as the effect of the plan as a whole does not favor executives, stockholders and officers.(1) To avoid confusion in a stock bonus plan it has been decided that stockholders will not be considered as such unless an individual owns, directly or indirectly, at least ten percent of the stock.

5. Bona Fide and Valid Trust

A bona fide and valid trust is required unless the plan is contractual, that is, some type of annuity plan with an insurance company. The reasons for this requirement are to assure that the plan is organized and operated in good faith with the intention to confer upon a substantial part of the employer's personnel the benefits of a fair and con-

(1) Senate Report No. 1631, 77th Congress, Revenue Bill for 1942.

tinuous plan, to see that the trust is not set up merely for tax evasion by shifting profits from one year to another, and to assure that no part of the corpus or income will revert to the employer or be used for any purpose other than for the exclusive benefit of the employees.(1) There is no special form to be observed in Massachusetts for setting up a trust it is only necessary that there be the intention to establish one, therefore the word "valid" cannot refer to legal validity but means an actual segregation of funds, taking them out of the employer's control.

C. Amounts Deductible

In general, the deductibility of contributions to employees' pensions may be considered in three groups. The trust types of plans, the profit sharing types, and where there is really no plan at all.

1. The Trust Type

The basic amount allowed as a deduction under this type of plan is five percent of the wages paid to participating employees during that year. The five percent is figured on the participating group as a whole, however, so payments for any one employee may be more or less than five percent of his earnings. The amount of contribution must have been actuarially computed and if the amount necessary is found to be

(1) Reaearch Institute of America, op. cit., p.7.

less than the five percent the deduction will be limited to that lesser amount.

If it is found that the amount of contribution necessary exceeds the basic five percent there are two other alternative methods of determining the amount allowable as a deduction in any one year. The first of these is called the "level method" and is based upon the determination of the amounts necessary to be paid each year to finance the past and future service benefits on level premium basis over the remaining years to the employee's retirement. The full amount of contribution determined under this method is deductible in the year paid without reference to any five percent limitation. This method is of great use when an annuity type of plan is being used and is applicable whether or not there is an intervening trust.

The other optional method, applicable to a trust or annuity plan, is to permit deduction for the amount necessary for "normal cost", what the contribution would be had the employees been covered from the time they entered the employer's service, plus one tenth of the amount necessary to pay for past services. That is, the cost of past service credits are to be spread over a period of ten years.

This discussion of the three allowable methods of determining deductions is really an over simplification of the provisions of Section 23 (p) of the Internal Revenue Code and the corresponding sections of Regulations 111. These

provisions apply to any formal type of pension whether a pensiom trust, annuity plan with an insurance company, a profit sharing plan where benefits can be actuarially determined, or the payment of benefits directly by the employer to retired workers under a plan. There is one other provision particularly worthy of note which allows that if payments in one taxable year exceed the allowable deduction for that year the excess may be carried over to any succeeding taxable year in which the contributions are less than the allowable deductions.

2. <u>The Profit Sharing Type</u>

If a profit sharing plan pays pensions that may be computed actuarially then the employer's contributions must be deducted under the same provisions as for any other type of pension plan. It is recognized that ordinarily a pension under a profit sharing system will not be of this type so special provisions are made. A profit sharing system's accumulations toward retirement benefits are expected to vary with the profits of the employer, being larger in good years and smaller in poor. To allow for the larger contributions in good years the limit is set at fifteen percent of the earnings of the members, instead of the five percent allowed for other plans, but the contributions are still limited by a percentage of earnings and not a percentage of profits, as might be expected. There are also carry back and carry forward provisions for profit sharing contribution deductions but the effect is to limit the total deduction in any one

year to fifteen percent of the members' earnings and allow an employer to deduct any excess in a year when his current contributions are less than fifteen percent.[1]

3. <u>Where There is No Plan</u>

If there cannot be found any plan to an employer's retirement payments to employees then deduction of the expense is not subject to Section 23 (p) but is subject to Section 23 (a) and would be deductible only if found to be "ordinary and necessary expenditures directly connected with...taxpayer's...business". The provisions for when there is no plan are not to be confused with the situation when there is a plan but it is not set up on a formal basis. When there is a plan having the same effect as a formal plan it is still governed by section 23 (p) of the Internal Revenue Code.

(1) Regulations 111, Section 29, 23 (p) (1) (C)-1.

SECTION VIII

INDUSTRIAL PENSIONS UNDER FEDERAL INCOME TAX (CONTINUED)

VIII INDUSTRIAL PENSIONS UNDER FEDERAL INCOME TAX (CONTINUED)

A. Taxes on Distributions

Ordinarily contributions to a pension plan by an employer are not taxable to the employee, but the distributions from the plan to the employee upon retirement, or other condition, are taxable to the employee.

1. Normal Distribution as a Pension

When benefits are distributed to a retired employee as pension there is usually one or the other of two situations: Either the employee has made contributions to the plan or all the costs have been paid by the employer. If all the costs have been paid by the employer then all the pension payments received by the employee are fully taxable to him the same as though they were salary or wages. If the employee's total income for the year exceeded his deductions and normal and surtax exemptions he would pay the regular individual income taxes as most lately amended by the Individual Income Tax Act of 1944.

If, on the other hand, the employee has made contributions towards the pension plan then benefits received under it are taxable to him as an annuity. As an annuity part of the periodic payments are considered to be income and part a return of investment, consequently the Internal Revenue Code takes cognizance of this and requires that

three percent of the employee's premiums be included each year in taxable income and the balance applied against the employee's cost until such time as the full cost has been recovered. After that all payments received must be included in taxable income in full.(1)

It is not clear whether it is meant that a retired employee should recover his cost out of pension payments purchased by both the employer's and employee's contributions or only out of that part of each payment purchased by the employee's contributions. If the latter should be the correct procedure then each year's benefits must be split on the percentage that employee's contributions are to the whole, three percent of the total employee's contribution and that part of the pension paid for by the employer all reported as income and only the balance purchased by the employee applied against his cost. It seems most logical to allow the employee to recover his cost only out of that part of the benefits purchased by him.

2. <u>Distribution For Other Reasons</u>

The total amount accumulated for the benefit of an employee may be distributed to him in one taxable year because of his leaving the employ of the company having the pension plan. When this is the case the employee, of course, recovers his contributions tax free as a return of capital and he is taxed on his employer's contributions paid to him as though

(1) Internal Revenue Code, Section 22 (b) (2) (B).

they were a long term capital gain.(1) For a long term capital gain under the present law only fifty percent of the gain is taken as taxable income. The payment is not subject to withholding for income taxes.

If the amount to the credit of the employee is distributed to him as a form of sickness or disability benefit then the entire amount distributed is exempt from personal income tax the same as any other sickness or disability benefits.(2) Payments to beneficiaries of any life insurance purchased under an annuity contract are also exempt from income taxes but if the amount needed to purchase the insurance exceeded the employee's contributions to the plan then that part of the employer's contribution that went towards the purchase of the insurance was taxable income to the employee in the year the employer made the contribution. This exemption does not apply to death benefits that are not insurance nor to benefits that are payable at a time fixed by the employee's death.(3)

B. Non-qualifying Plans

The tax disadvantages are so great that few can really afford to operate a pension plan that does not qualify for the various tax deductions and exemptions allowed by the

(1) Internal Revenue Code Section 165 (b).
(2) Internal Revenue Code Section 22 (b) (5).
(3) Regulations 111, Section 29. 165-6.

Internal Revenue Code to qualifying plans. Should some of the requirements be overlooked the employer and employees will find that they pay more taxes and may incur penalties under Wage and Salary Stabilization.

1. Employer's Contributions

Employer's contributions even to a non-qualifying trust may be deductible. The non-qualifying trust does not have to meet the requirements of minimum coverage and is not limited by the percentages of maximum deductions applicable to qualifying trusts, but there are four other conditions for it to meet for the employer's contributions to be deductible.[(1)] First, the trust must be a bona fide employees' trust which, although it may discriminate in favor of a few, must be for the benefit of employees and must not be a device to accumulate surplus or hide the distribution of dividends. The benefits must be measured by the value of the employees' services and not by their proprietary interests.

Second, when contributions to the pension plan are added to other compensation paid to the employee the total must remain within the limits of reasonable compensation. Third, the contributions to the non-qualifying plan must conform to the rules and regulations governing the stabilization of salaries and wages. Contributions to the plan cannot be increased except under the same rules and procedures that apply to other types of compensation. Fourth, the employees'

(1) Deductible under Internal Revenue Code Sec. 23 (a) instead of 23 (p) which is applicable to qualifying plans.

benefits must be non-forfeitable at the time the employer's contributions are made.(1)

2. Income to Employees

Under a qualifying trust there is no taxable income to the employee until such time as the employee starts to receive benefits from the plan. Not only is the taxation postponed but in the years when benefits are received the employees will be in lower surtax brackets and so receive real tax savings. A non-qualifying plan does not always give these benefits to the employees. Employees are taxed on the amount of the employer's contributions in the year it is paid unless the benefits are forfeitable. Premiums on life insurance purchased by the employer and payable to beneficiaries other than the employer, unless it is a group insurance policy, are taxable to the employee in the year the premiums are paid whether or not the insurance is purchased through a qualifying trust.

When an employee receives distributions from a non-qualifying plan under which he has been taxed for the employer's contributions to the plan, he is again taxed on the distribution but may recover as his cost the contributions of both the employer and employee.(2)

3. Status Under Salary Stabilization

Since October of 1942 when Congress set a limit to the increases in salaries and wages allowable, the establish-

(1) Internal Revenue Code, Section 23 (p) (1) (D).
(2) Internal Revenue Code, Section 22 (b) (2) (B).

ment and extending of pension plans has been a favorite means of giving the employee more, deferred, compensation. Qualifying pension plans are exempt to some extent under these wage stabilization rules as will be explained later on.(1) It is very definite, though, that any contributions to a non-qualifying plan have no exemption. Any increases in contributions to a plan are clearly salary and wages for wage stabilization purposes.(2)

C. Cancellation of Plans

A pension or other plan, to qualify, is supposed to be set up as something permanent, not a temporary expedient to avoid taxes or to meet a temporary manpower situation. The tax laws seek to encourage permanent plans for the benefit of employees. It is realized that situations will arise when the employer will really be financially unable to continue a plan once adopted, or some other reason will make it expedient to discontinue a plan. It is not prohibited that a plan for which deductions were taken for income tax purposes be discontinued but the reasons for discontinuance and all the circumstances will be scrutinized, especially if a plan is discontinued within a few years. One of the chief things the Treasury Department tries to guard against is discrimination effected by discontinuing a plan as soon as the

(1) See p.115
(2) Internal Revenue Code Section 1002.8, as amended by T. D. 5295.

older officers and supervisory employees are taken care of by the plan. As the Regulations say, "The term 'plan' implies a permanent as distinguished from a temporary program."(1)

D. Wage and Salary Stabilization

Insurance and pension benefits in a reasonable amount are excepted from the terms "salary" and "wages" for the purpose of the Salary Stabilization Act. Contributions to a non-qualifying trust do constitute "salary and wages" for purposes of stabilization even if they are not so classified under income tax definitions due to their being forfeitable at the time the contribution is made.(2) It will be found that for purposes of salary stabilization economic considerations will prevail over strict tax definitions.(3) If an employee does receive present income or the opportunity to convert benefits into present income, such benefits or income will be subject to salary stabilization rules.

Insurance, either group life or group health, with no cash surrender value may be purchased by the employer, deducted as a business expense, if reasonable in amount, and not constitute salary or wages. Regular insurance policies taken out on individuals and paid for by the employer are deductible by him and are includable in employee's taxable

(1) Regulations 111, Section 29. 165-1.
(2) Internal Revenue Code, Section 1002.8 as amended by T. D. 5295.
(3) The Research Institute of America, Inc., op. cit., p.27.

income but do not constitute wages or salary for purposes of stabilization except in so far as the premiums exceed five percent of employee's annual salary. For salary, in this case, insurance and pension are excluded. The insurance must be of the ordinary or whole life type without large cash surrender value.

In any case where there is doubt as to whether or not an item will be treated as salary or wages for stabilization purposes the Director of the Regional Salary Stabilization Unit should be consulted or else the Regional War Labor Board. Approval of profit sharing trust plans will be given when the employer's contributions are payable to the employee only in the event of retirement at a suitable age, death, disability or sickness, or after a fixed period of time of not less than ten years and then distributed over a period of years. Or if the plan provides for distribution upon termination of employment but not more than twenty percent of the amount to the employee's credit is distributed in any one year approval will also be granted.

Approval is not necessary if the trust was in existence prior to October 2, 1942 and the plan contains a specific formula for determining contributions as well as for allocating them to the accounts of the participants. If no specific formula for allocating to the accounts of participants is in existence no approval will be necessary if the same percentages are used as were used in the last year

ended prior to October 2, 1942. When no specific formula for determining contributions exists, no approval is necessary if the dollar amount in any year after October 2, 1942 does not exceed the amount contributed in the last year ended prior to October 2, 1942. Should the plan have been created after October 2, 1942 no approval is necessary if the plan meets the requirements of qualifying trusts and provides that distributions will be made only upon participant's death, retirement, sickness, or disability.

Penalties for violation of stabilization laws include the disallowance for income taxes of the total earnings of any person whose income has been increased in violation of the provisions.

SUMMARY

SUMMARY

An industrial pension is an income to an employee retired because of age, paid to him at regular periods from funds provided directly or indirectly by his employer, a business organization, in consideration for past services. It is something earned. The need for industrial pensions arose as the frontier disappeared and the nation became industrialized. The depression, Social Security, the war and taxes have all aided the growth in coverage by industrial pensions.

Employers are benefited, when they have an industrial pension system, by a cut in labor turn over, increased morale and loyalty of employees, attraction of better employees, the humane retirement of those too old to work, and better public relations and goodwill. The employees benefit by relief from worry, a better group of fellow workers, and what amounts to a substantial indirect pay increase. Pension plans have evolved from employers' weapons to coerce workers into genuine attempts to solve a social problem.

The trend is towards making pensions available to all employees on a contributory basis, increasing the benefits as the length of service increases and vesting some rights in the employees. Disability, death, and other benefits which are not strictly a part of a pension system may be included. Of the formal plans there are two basic

insurance plans, group annuities and individual annuities, underwritten by an insurance company they are safe investments and make the addition of a life insurance element very easy. Pension trusts in their older form did not use insurance as a principal means of investment but today they often do. A pension trust is a separate entity that holds legal title to a plan's assets, may manage and invest them, and pays benefits to members according to provisions of the plan. Deferred profit sharing plans may or may not be pension plans, their chief emphasis is upon making profits to share with employees.

Social Security legislation is important because it gives a small pension that may be easily added to by an inexpensive industrial pension plan. The general interest in old age pensions was much aroused and increased by the Act; people who had given little thought to retirement incomes now had the subject brought to their attention. The Act's exclusion of wages in excess of three thousand dollars has caused many problems but also has been the incentive to do something for those employees who earn more than three thousand dollars a year.

The Revenue Act of 1942 which tightened up on the requirements for a qualifying plan for income tax purposes has been the most recent event to cause concern among employers having industrial pension systems. Some plans had to be changed to correlate them with Social Security; now

some plans must be changed again to qualify them under the rigid provisions of the 1942 act.

Labor has traditionally opposed industrial pension systems on the theories that they withheld wages from the employee that would otherwise be paid to him in cash, and they tended to tie a man to a job when he might obtain better conditions of employment somewhere else. Now that, through the government's intervention, labor has gained such wide recognition it feels that it can afford to drop some of its opposition to industrial pensions. The war has also been instrumental in changing labor's attitude for with wages frozen all types of indirect, allowable, increases are welcomed.

The tremendous recent growth in number of plans has been noted, now it remains to be seen whether or not these plans remain in existence after the war. It is certain that many of these plans will go out of existence due to the employer running into financial difficulties when war inflated business drops off. On the other hand, I believe that most of the plans will continue to exist because of income taxes, labor's new attitude, and the growing social consciousness. While income tax laws do not prohibit the discontinuance of qualified plans once they are started the reasons for discontinuing them will be carefully considered. Also labor, as long as it continues to approve industrial pensions, does not easily give up benefits once obtained. These two reasons will be effective in curbing cancellations

but also the growing social consciousness of the need for provisions for the aged will have its effects.

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